IN THE

Supreme Court of the United States

October Term, 1979

No. 79-640

Bernard Goldberg, Reuben Mitchell, Joseph Shannon, Robert Christen, Victor Condello, Harrison J. Goldin, James Regan, individually and as Trustees of the Teachers' Retirement System of the City of New York and Isaiah Robinson, individually as former Trustee of Teachers' Retirement System,

Petitioners,

v.

Alfred Kirshner,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT ON BEHALF OF THE TRUSTEES OF THE TEACHERS' RETIREMENT SYSTEM OF THE CITY OF NEW YORK

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Petitioners, the Trustees of the Teachers' Retirement System of the City of New York, seek a writ of certiorari to review a judgment of the United States Court of Appeals for the Second Circuit reversing an order of the United States District Court for the Southern District of New York which dismissed the complaint.

The Second Circuit, by a divided panel, has dramatically expanded the category of persons who may sue in federal court for alleged violations of the securities laws' antifraud provisions, in conflict with the purchaser-seller limitation on standing enforced by this Court in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975). The opinion below also conflicts with this Court's holding in *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 477-479 (1976), that an alleged breach of fiduciary duty does not create a federal securities law claim unless the securities transaction at issue involved material nondisclosure or deception as between the purchaser and seller.

Additionally, the Second Circuit has proclaimed the existence of an implied right of action under §17(a) of the Securities Act of 1933, contrary to this Court's teaching in two recent cases and in conflict with the Eighth Circuit.

Opinions Below

The opinion of the Court of Appeals (as yet unreported) is annexed as Appendix A. The Court of Appeals' orders denying the petition for rehearing and the memorandum attached thereto are annexed as Appendix B. The unreported opinion of the District Court dated June 15, 1977 is annexed as Exhibit C.

Jurisdiction

The judgment of the Court of Appeals was entered on November 30, 1978. The Trustees' timely petition for rehearing with a suggestion for rehearing *en banc* was denied on July 19, 1979. This Court's jurisdiction is invoked under 28 U.S.C. §§1254(1) and 1331.

Questions Presented

1. Does a retired member of a public retirement fund, who continues to receive the full amount of the fixed annuity and pension allowance to which he is entitled, have a sufficient interest in the fund to have standing to sue derivatively on behalf of the fund to challenge investments made by the Trustees of the fund under §17(a) of the Securities Act of 1933 or §10(b) of the Securities Exchange Act of 1934?

2. In view of plaintiff's admission that the Trustees of the pension fund had full knowledge of New York City's financial condition at the time of the challenged investments, is the holding of the Court of Appeals that plaintiff's allegations of fraud and nondisclosure state a claim against the Trustees cognizable under the federal securities laws contrary to this Court's decision in *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977)?

3. Does the implication of a private right of action under §17(a) of the Securities Act of 1933 contravene the criteria enunciated by this Court in *Touche Ross & Co.* v. *Redington*, —— U.S. ——, 99 S.Ct. 2479 (1979), and *Cannon* v. *University of Chicago*, —— U.S. ——, 99 S.Ct. 1946 (1979)?

Statement of the Case

Plaintiff Kirshner, a retired teacher and recipient of a pension from the New York City Teachers' Retirement System (hereafter "TRS"), commenced this action for damages and declaratory and injunctive relief challenging

the investments made by the Trustees of the TRS in securities of the Municipal Assistance Corporation ("MAC") and New York City (B5, 10).* The challenged investments were made pursuant to the Amended and Restated Agreement dated November 26, 1975 (the "Agreement"), entered into by eleven New York City commercial banks, the New York City pension and sinking funds, and MAC (B5).

The Complaint

Plaintiff's complaint, dated February 10, 1977, alleges that the TRS investments in New York City and MAC bonds gave rise to claims under Article 1, Section 10 and the Fifth and Fourteenth Amendments to the United State Constitution, violated section 1983 of 42 U.S.C., section 10(b) and rule 10b-5 of the Securities Exchange Act of 1934 (15 U.S.C. §78j(b), 17 C.F.R. §240.10b-5) and section 17(a) of the Securities Act of 1933 (15 U.S.C. §77q(a)). It further alleges that Public Law 94-236, which continued the tax-exempt status of the five New York City Retirement Systems participating in the Amended and Restated Agreement, was unconstitutional (B5, 9, 14).

According to the complaint, the banks, "while ostensibly acting as disinterested parties, while using their reputations for fiscal integrity, and sound business judgment to induce the 'TRUSTEES' to purchase $860 million of NYC serial bonds, failed to make full disclosure of the fact that they had sold over $2 billion of their NYC short term notes in the previous year." The banks "fail[ed]

* Unless otherwise indicated, numbers in parentheses preceded by a letter refer to the Appellant's Appendices submitted to the Court of Appeals. All other references are to the original papers.

to disclose the extent and dollar value of the City Bonds held by them as assets and as trustees and fiduciary for clients [thereby] concealing material facts that would affect an informed investment decision" (Compl., p. 6).*

At the same time, however, the complaint further alleges that the Trustees, when entering into the Agreement, "were well aware that buying NYC bonds at that time was wrongful because the City was insolvent. In April, 1975, Standard & Poor had completely suspended rating NYC bonds. Moody's had downrated them to unsatisfactory Caa on November 3, 1975 . . . Not one bank, insurance company, investment company, trade union fund or corporation in the USA would at that time advance NYC any funds. . . ." (Compl., p. 10).

Proceedings Below

On June 17, 1977, the United States District Court for the Southern District of New York (Pierce, J.), entered a judgment dismissing the complaint upon motion by the defendants. The District Court held that neither the investments nor P. L. 94-236 violated the Contracts Clause or the Fourteenth Amendment. With respect to the claims under the securities laws, the District Court held that plaintiff lacked standing since the plaintiff was neither the purchaser nor seller of the securities in question and, at best, alleged a state claim of breach of fiduciary duty not cognizable under federal law.

On November 30, 1978, the United States Court of Appeals for the Second Circuit reversed by a divided panel

* Notwithstanding these allegations, however, plaintiff did not sue any of the banks, nor any officer or director of any bank.

that part of the judgment which dismissed the claims under the securities laws, and affirmed the dismissal of the remaining claims.* In reversing the District Court, the Court of Appeals held that an implied private right of action exists under §17(a) of the Securities Act of 1933, and that plaintiff, as a beneficiary of a public pension fund, has standing to sue derivatively on behalf of the fund under both §17(a) of the 1933 Act and §10(b) of the Securities Exchange Act of 1934. The Court further held that the complaint alleged a claim of fraud cognizable under the securities laws.

On January 4, 1979, the Trustees petitioned for rehearing with a suggestion for rehearing *en banc.* While the petition was pending, this Court decided *International Brotherhood of Teamsters* v. *Daniel,* 439 U.S. 551 (1979). The Court of Appeals was advised by letter dated January 24, 1979, of this Court's decision in *Daniel,* and of its implications for the case at bar, to wit:

> . . . that neither the annuity nor pension aspect of Kirshner's interest in the Retirement System satisfies the elements of an investment contract set forth by the Supreme Court in *Daniel, Howey* [*S.E.C.* v. *Howey,* 328 U.S. 293 (1946)] or *SEC* v. *Variable Annuity Life Ins. Co.,* 359 U.S. 65 (1959). Since Kirshner's interest in the Retirement System is not a "security" that interest may not be protected either directly or derivatively under the Securities Acts.

On July 19, 1979, the Court of Appeals denied the petition for rehearing, holding that it was not necessary to

* On May 29, 1979, this Court denied a petition for a writ of certiorari to review the dismissal of plaintiff's other claims. 47 U.S.L.W. 3775 (Dkt. No. 78-1403).

consider what type of interest plaintiff Kirshner has in the pension fund in determining whether he has standing to sue derivatively on behalf of the fund. In denying rehearing, the Court of Appeals further stated:

> *Daniel* also has no effect on our conclusion that a private right of action exists under §17(a) of the 1933 Act, 15 U.S.C. §77q, since the Court found it unnecessary to reach that issue. 47 U.S.L.W. at 4136 n. 9.

The Amended and Restated Agreement of November 26, 1975

In the fall of 1975, the City of New York faced a serious financial crisis and was in imminent danger of default.* Eleven New York City commercial banks, MAC, the five City pension systems and sinking funds agreed to participate in the three-year plan for the financial recovery of the City and entered into the Amended and Restated Agreement dated November 26, 1975.** Pursuant to the Agreement, the Trustees agreed to invest $860 million in New York City Serial Bonds or MAC bonds by June 30, 1978.

* See the legislative findings contained in Chapter 168 of the New York Laws of 1975 (the "New York State Municipal Assistance Corporation Act"), Chapter 868 (the "New York State Financial Emergency Act for the City of New York"), and Chapter 874 (the "New York State Emergency Moratorium Act for the City of New York").

** The purchases by the pension and sinking funds were contingent on the issuance of a ruling by the Internal Revenue Service that such purchases would not cause the purchasers to lose their tax-exempt status. Kirshner challenged the I.R.S. ruling. The ruling was upheld by the District Court and the Court of Appeals (Appendices A and C). A petition for certiorari was filed by Kirshner to review the portion of the Court of Appeals' decision which upheld the I.R.S. ruling. The petition was denied by this Court on May 29, 1979. 47 U.S.L.W. 3775, Dkt. No. 78-1403.

The Teachers' Retirement System

The New York City Teachers' Retirement System ("System") is funded by employer and employee contributions and investment income. Approximately 62% of the annual income derives from employer contributions; 7% from employee contributions; and 31% from investment income. Employer contributions are computed taking into account any shortfalls in earnings as well as any losses realized on the sale of the assets of the System (Administrative Code of the City of New York §§B20-26.0,-30.0, E49-4.0). Management of the investment of the System's assets is vested exclusively in the Trustees, comprised of the President of the New York City Board of Education or his designee, the City Comptroller, two persons appointed by the Mayor, one of whom shall be a member of the Board of Education and three members of the Retirement System elected by the contributors (Admin. Code §§B20-31.0).

Plaintiff Kirshner was a member of the TRS from 1928 to 1953 while employed as a teacher by the New York City Board of Education, during which time he made mandatory contributions to the System from his salary. Since his retirement in 1953, plaintiff has received and continues to receive a fixed retirement allowance of approximately $3,000 per annum (B13).

Plaintiff's retirement allowance is comprised of three separate parts: a fixed annuity which is based solely on compulsory employee contributions, together with interest thereon (Admin. Code §§B20-20.0,-21.0); a pension, paid out of employer contributions together with interest and

investment income (Admin. Code §§B20-26.0,-27.0); and a supplemental pension paid directly out of general revenues of the City (Admin. Code §B20-44.1). Plaintiff receives $519 per annum from the fixed annuity; $1207 from the pension fund; and $1300 in supplemental pension funds.

Retirees have no right to withdraw their contributions nor to receive their retirement allowance in a lump sum (Admin. Code §B20-44.0). Payment of retirement allowances is guaranteed by the City of New York (Admin. Code §B20-30.0), and shall receive the same priority in bankruptcy as the essential services (Chapter 890, New York Laws of 1975). There is no question in this case that the amount of plaintiff's retirement allowance is not affected by fluctuations in the value of the assets of the TRS.

Reasons for Granting the Writ

In holding that a fixed-income pensioner of a public retirement fund has standing to sue derivatively the trustees of the fund under the anti-fraud provisions of the federal securities laws, the opinion of the Court of Appeals conflicts with this Court's decision in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975), which had approved, and adopted, the "purchaser-seller" limitation on standing promulgated in *Birnbaum* v. *Newport Steel Corp.,* 193 F. 2d 461 (2d Cir.), *cert. den.* 343 U.S. 956 (1952). The Second Circuit's holding in the case at bar constitutes a dramatic expansion of the exception permitting corporate shareholders to sue derivatively where fraudulent purchases or sales of securities by the corporation threaten the value of their equity investment.

Respondent Kirshner is a retired teacher. His only entitlement with respect to the fund is to receive a fixed sum of money annually. He cannot sell his interest, and its value cannot increase or diminish depending upon the success or failure of the fund's investment policy. By any rational analysis Kirshner is akin to a creditor or debenture holder, groups which do not have standing to bring derivative suits.

Unless this Court acts here to reverse the Second Circuit, the effect will be far-reaching. Not only will this plaintiff be permitted to harass and burden the Trustees through protracted discovery and a plenary trial, but scores of thousands of other retired, fixed-income pensioners will instantly become potential securities law plaintiffs—contrary to the holding and policy of *Blue Chip Stamps.* Indeed, there are more than 25,000 retirees of the TRS alone, and four other public New York City pension funds with more than 100,000 retired members. In addition, the decision below could extend a right to bring derivative actions under the federal securities laws to all retirees of public and private pension funds, as well as to trust beneficiaries, bondholders, debenture holders and even general creditors.

The decision below also conflicts with this Court's holding in *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462, 477-479 (1976), that alleged breach of fiduciary duty relating to corporate mismanagement does not create a cause of action under §10(b), unless the securities transaction at issue involved material nondisclosure or deception as between the purchaser and seller. Here, the essential allegation is that the Trustees purchased New York City and MAC bonds at a time when they had full knowledge that "the City was insolvent." The accusation is not one of concealment. To the contrary, it is that unsound investments were made by Trustees possessed of the full facts, in order to help avert default for New York City and thus protect the jobs and salaries of teacher members of the retirement system who, unlike Kirshner, had not yet retired. The claim, if it is anything at all, is one for breach of fiduciary duty cognizable under state law. The Second Circuit's decision to recognize a federal cause of action here conflicts with this Court's holding and reasoning in *Santa Fe.*

The Second Circuit panel majority also announced the existence of an implied private right of action under §17(a) of the Securities Act of 1933. It did so, without benefit of briefing or oral argument on the issue, citing the Seventh Circuit's decision in *Daniel* v. *International Brotherhood of Teamsters,* 561 F.2d 1223, 1244-46 (7th Cir. 1977), *reversed,* 439 U.S. 551 (1979). The implication of a private right of action under §17(a) of the 1933 Act is contrary to this Court's teaching in *Touche Ross & Co.* v. *Redington,* —— U.S. ——, 99 S.Ct. 2479 (1979), and *Cannon* v. *University of Chicago,* —— U.S. ——, 99 S.Ct. 1946 (1979). In addition, the decision conflicts on this point with the contrary rule in the Eighth Circuit. *Shull* v. *Dain, Kalman & Quail, Inc.,* 561 F.2d 152 (8th Cir. 1977), *cert. den.* 434 U.S. 1086 (1978).

1. The decision below conflicts with this Court's holding in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975).

A retired member of a public retirement fund, who continues to receive the full amount of the fixed annuity and pension allowance to which he is entitled, does not have a sufficient interest in the fund to have standing to challenge investment decisions made by the trustees of the fund under section 17(a) of the Securities Act of 1933 or §10(b) of the Securities Exchange Act of 1934.

The pensioner's interest in the pension fund is not a security within the meaning of the Securities Acts. *International Brotherhood of Teamsters* v. *Daniel,* 439 U.S. 551 (1979). There, this Court held that an employee's interest in a noncontributory compulsory pension plan does not constitute a security within the meaning of the Securities Act of 1933 or the Securities Exchange Act of 1934. The decision was predicated upon the criteria set forth in *S.E.C.* v. *Howey,* 328 U.S. 293 (1946).

Similarly, in *United Housing Corp.* v. *Forman,* 421 U.S. 837 (1975), this Court applied the *Howey* criteria and held that shares in a cooperative apartment project are not governed by the securities laws. The Court noted that the cooperative shareholder did not satisfy the "expectation of profit" test, rejecting the argument that the test could be met by plaintiff's potential financial loss if the cooperative became bankrupt. *Id.* at 852, 857.

The principles applied in *Daniel, Howey,* and *Forman, supra,* support the conclusion that Kirshner's interest in the Teachers' Retirement System is not a security under

either the 1933 or 1934 Acts. With respect to Kirshner's interest in the pension aspect of his retirement allowance, *Daniel* is dispositive since Kirshner's interest is both compulsory and noncontributory. As in *Daniel,* the purported investment of his services constitutes only a small part of his "total and indivisible compensation package" which he received and is not the traditional investment intended to be covered by the federal securities laws. The same principle applies to the smaller fixed annuity aspect of the fund since, although contributory, it is compulsory and likewise an indivisible part of the compensation package.

Similarly, Kirshner's "investment" in both the annuity and pension aspects of the plan was not based on an expectation of profits to be derived from the entrepreneurial effort of others. The annuity is simply a return of employee contributions, together with interest. As in *Daniel,* the pension derives primarily from employer contributions rather than investment income earned on the assets of the System. The employer contributions are computed taking into account any shortfalls in earnings, or losses realized on the sale of assets. Moreover, the retirement allowance is not subject to fluctuation depending upon the financial health of the principal fund, and payment of the allowance is guaranteed by the City of New York (Admin. Code §B20-30.0), so that even bankruptcy of the System would not affect Kirshner's interest.

Finally, Kirshner's interest in the plan was, as in *Daniel,* subject to various preconditions to vesting. Thus, as this Court stated:

> [e]ven if it were proper to describe the benefits as a "profit" returned on some hypothetical investment by

> the employee, this profit would depend primarily on the employee's efforts to meet the vesting requirements, rather than the Fund's investment success. When viewed in light of the total compensation package an employee must receive in order to be eligible for pension benefits, it becomes clear that the possibility of participating in a plan's asset earnings "is far too speculative and insubstantial to bring the entire transaction within the Securities Acts," [*United Housing Corp.* v. *Forman,* 421 U.S. 837, 856 (1975)].

Daniel, supra, at 562.

This Court in *Daniel* found further support for its conclusion that Daniel's interest in the fund was not a security in the enactment of ERISA in 1974, 29 U.S.C. §§1021 *et seq.* The enactment of "the comprehensive legislation governing the use and terms of employee pension plans severely undercuts all arguments for extending the Securities Acts to non-contributory, compulsory pension plans." *Daniel, supra,* at 569-70.

Judge Moore, in his dissent below, advanced a similar argument concerning ERISA:

> "[A] rational enforcement system ought to take into account the latest efforts of Congress to regulate retirement trust fund managements. In the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. §§1001-1381, Congress has established detailed and complex rules to control pension fund managers. In pertinent part, ERISA provides that pension fund trustees have a duty of undivided loyalty to the beneficiaries, 29 U.S.C. §1104, and regulates the extent to which a pension fund can hold securities issued by the employer, 29 U.S.C. §§1106-1107. ERISA contains complex disclosure and reporting re-

> quirements, but nowhere does it require that trustees must disclose in advance to the beneficiaries their proposed investment transactions, 29 U.S.C. §§1021-1026. If Congress had wanted to require pension funds trustees to disclose investment transactions, Congress would have enacted such a rule. Although this case involves a public employee pension fund, the majority's holding that a pension beneficiary has a cause of action against the trustee is equally applicable to private pension funds which are covered by ERISA. Moreover, since Congress has elected not to burden municipal employee pension funds with ERISA's requirements, 29 U.S.C. §1003, a federal court should not create a new disclosure duty on the dubious foundation of §10(b) and apply it to public employee pension funds in this case."

Significantly, Kirshner, as the Second Circuit noted in denying the petition for rehearing, "does not claim that his pension interest under the System is a security. He contends rather that fraud was perpetrated by the Trustees in connection with the fund's purchase of MAC and NYC bonds, which the trustees cannot and do not contend are not securities." In short, the Second Circuit, notwithstanding this Court's decision in *Daniel,* appears to hold that the nature of Kirshner's interest in the pension fund is irrelevant to his right to bring a derivative suit under the federal securities laws. This conclusion by the Court of Appeals is error. Since Kirshner's interest in the TRS is not a security within the meaning of the Securities Acts, he should not be allowed to sue in a derivative action under the federal securities laws to protect that interest.

Moreover, the decision of the Court of Appeals granting Kirshner standing to sue derivatively on behalf of the fund

is contrary to the decision of this Court in *Blue Chip Stamps, supra,* 421 U.S. 723 (1975). In *Blue Chip,* this Court, in affirming the purchaser-seller limitation for standing under §10(b), noted that courts have permitted derivative actions on behalf of shareholders to raise §10(b) claims. This Court's language, however, carefully separated "shareholders" from "creditors, and perhaps others related to an issuer who suffered loss in the value of their investment due to corporate or insider activities in connection with the purchase or sale of securities which violate Rule 10b-5." 421 U.S. at 738. The former have standing, the latter do not.

Consistent with the decision in *Blue Chip Stamps,* the Court of Appeals for the Fifth Circuit has held that a debenture holder cannot maintain a derivative suit under the Securities Acts. *Darrow* v. *Southdown Inc.,* 574 F. 2d 1333 (5th Cir. 1978), *cert. den. sub nom. Mize* v. *Darrow,* 439 U.S. 984 (1978). See also *Dorfman* v. *Chemical Bank,* 56 F.R.D. 363, 365 (S.D.N.Y. 1972).

The decisions prohibiting a creditor or debenture holder from bringing a derivative action are consistent with the purpose of the Securities Acts. The shareholder's equity interest is subject to real economic diminution in the event of a fraudulent purchase or sale by the corporation, specifically evidenced by his ability to sell his interest on the market and the potential for loss of dividends. It is that ownership interest and attendant economic reality which this Court recognized in permitting the shareholder's derivative action notwithstanding the *Birnbaum* doctrine. See *Schoenbaum* v. *Firstbrook,* 405 F. 2d 215 (2d Cir. 1968), *cert. den. sub nom. Manley* v. *Schoenbaum,* 395 U.S. 906 (1969).

Plaintiff Kirshner's only interest is in receiving a fixed retirement allowance. As we noted above, that interest in his pension is not based on an expectation of profits to be derived from the entrepreneurial efforts of others. Upon the vesting of his interest, plaintiff's right to receive a pension is similar to that of a creditor or debenture holder and is even less subject to risk by virtue of the City guarantee, which is set forth in the Administrative Code of the City of New York and guaranteed by Article V, Section 7, of the New York State Constitution. Under such circumstances, Kirshner does not have standing to bring a derivative action.

In reaching its determination, the Court of Appeals relied upon the decisions in *James* v. *Gerber Products Co.,* 483 F. 2d 944 (6th Cir. 1973), and *Heyman* v. *Heyman,* 356 F. Supp. 958 (S.D.N.Y. 1973). In both cases, as well as in *Klamberg* v. *Roth,* 425 F. Supp. 440 (S.D.N.Y. 1976), some ownership interest and indicia of potential for real loss were present. In each case the plaintiff stood to gain or lose by virtue of the success or failure of the management of the trusts, unlike Kirshner, who has a guaranteed fixed income therefrom. To the extent that *James, Heyman* or *Klamberg* can be construed to cover the situation in which the plaintiff, as here, has a fixed income, these cases are inconsistent with *Blue Chip Stamps.*

Recognition of a derivative right of action based upon the attenuated interest of plaintiff in the pension fund would give rise to precisely the ills envisioned by this Court in *Blue Chip Stamps.* There, this Court expressed the fear that the further expansion of the *Birnbaum* doctrine would result in baseless, vexatious litigation having

an "in terrorem settlement value." *Blue Chip Stamps, supra,* 421 U.S. at 741. That concern was recognized by Congress in enacting provisions limiting the potential for strike suits. See, *e.g.,* 15 U.S.C. §77k (undertaking for costs and attorneys' fees); 15 U.S.C. §78p (demand upon issuer required prior to bringing derivative suit).

The decision of the Court of Appeals in the instant case erodes the purchaser-seller limitation in such a manner as to assure a substantial increase in "vexatious litigation" which this Court refused to countenance in *Blue Chip Stamps.* Pursuant to the Court of Appeals' decision, not only the 25,000 retirees of the Teachers' Retirement System would have standing to sue, but also the scores of thousands of retirees of public and private pension funds as well as bondholders, debenture holders, general creditors and other trust beneficiaries.

2. The decision below conflicts with this Court's holding in *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462 (1977).
At most, plaintiff is complaining of a breach of the Trustees' fiduciary duties which should be reviewed in the state courts.

Even were this Court to sanction the maintenance of a derivative right of action here, the Court of Appeals nevertheless erred in holding that plaintiff states any claim cognizable under the 1933 or 1934 Acts. In *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462, 479 (1977), this Court held that a breach of fiduciary duty constituting corporate mismanagement does not state a claim under the federal securities laws, unless the mismanagement resulted

from nondisclosure or fraud between the purchaser and seller of the securities.

In the instant case, the plaintiff has failed to allege any material nondisclosure or deception which tainted the transaction between the Trustees and the City and MAC. To the contrary, plaintiff alleges that the Trustees had full knowledge that "the City was insolvent" at the time of the transactions in City bonds (Compl., p. 10). It is difficult to imagine what other disclosures the City could have made which would have been material and would have affected an informed investment decision.

Plaintiff alleges that the commercial banks which were parties to the Amended and Restated Agreement failed to disclose the fact that they had sold their City holdings in the previous year. However, any alleged nondisclosure by the banks, who are not parties, does not state a claim against the Trustees of the TRS, the only defendants in this action.

The only allegation of fraud against the Trustees is that they failed to disclose certain information to the Internal Revenue Service in requesting rulings regarding the continuation of the tax-exempt status of the pension systems. However, as this Court in *Santa Fe* set forth, §10(b) is concerned with nondisclosure between the purchaser and seller which affects an informed investment decision, not with other types of alleged fraud or nondisclosure where the investment decision is made with full knowledge of all material facts. *Santa Fe, supra,* at 478-79. *See also O'Brien* v. *Continental Illinois National Bank and Trust,* 593 F.2d 54 (7th Cir. 1979); *Maldonado* v. *Flynn,* 448 F. Supp. 1032 (S.D.N.Y. 1978).

3. No private right of action may be implied under section 17(a) of the Securities Act of 1933 in light of the criteria announced by this Court in *Redington* and *Cannon*.

Having decided that plaintiff had standing and that the complaint stated a claim under §10(b) of the 1934 Act, the Court of Appeals, without the benefit of briefs or argument from the parties, determined that §17(a) of the Securities Act of 1933 supports the judicial implication of a private right of action. That decision has already been cited as controlling authority for liability under the federal securities laws in situations in which it is contended that no cause of action has been stated under §10(b) of the 1934 Act. Petitioners submit that the holding of the Court of Appeals ignores the teaching of *Touche Ross & Co.* v. *Redington,* —— U.S. ——, 99 S.Ct. 2479 (1979), and *Cannon* v. *University of Chicago,* —— U.S. ——, 99 S.Ct. 1946 (1979), and does violence to the statutory scheme of civil liabilities imposed by the 1933 Act.

This Court held in *Redington* that the focus of any inquiry with respect to a particular statute must be "whether Congress intended to create, either expressly or by implication, a private cause of action." 99 S.Ct. at 2489. Once it has been determined that (a) the legislative history of the enactment does not speak to the issue of private remedies under the provision in question, and (b) the language of the provision itself creates duties for the protection of the general public rather than rights on behalf of a special class, the question of whether Congress intended to create a private right of action has been definitively an-

swered in the negative. *See Redington,* 99 S.Ct. at 2489; *Cannon,* 99 S.Ct. at 1954 and n. 13.

Certainly the legislative history of the 1933 Act does not speak of a private remedy in connection with §17(a). It suggests no reason to believe that the provision was intended as anything more than a means by which the government might seek an injunction in district court or criminally prosecute the offender. As Judge Friendly concluded, concurring in *SEC* v. *Texas Gulf Sulfur Co.,* 401 F. 2d 833, 867 (2d Cir. 1968), *cert. den. sub nom. Coates* v. *SEC,* 394 U.S. 976 (1969):

> [T]here is unanimity among the commentators, including some who were in a peculiarly good position to know, that §17(a)(2) of the 1933 Act—indeed the whole of §17 was intended only to afford a basis for injunctive relief and, on a proper showing, for criminal liability, and was never believed to supplement the actions for damages provided by §§ 11 and 12.

The language of §17(a), in light of *Redington* and *Cannon,* is even more indicative of the Congressional intent. In *Cannon,* this Court drew a distinction between "statutory language describing the special class to be benefited" (right-creating language) and "language customarily found in criminal statutes . . . and other laws for the protection of the general public" (duty-creating language). 99 S.Ct. at 1954. Thus, while in the case of right-creating provisions it has, almost invariably, permitted inference of a damage remedy in favor of the special class to be benefited, the Court "has been especially reluctant to imply causes of action under statutes that create duties on the part of persons for the benefit of the public at large." 99 S.Ct. at 1955 n. 13.

The language of §17(a) is virtually identical to that of §14(e) of the 1934 Act, construed in *Piper* v. *Chris-Craft,* 430 U.S. 1 (1977), as well as that of §10(b). Section 14(e) appears first on the list of the Court in *Cannon* of "duty-creating" enactments. 99 S.Ct. at 1954-55 n. 13. Section 10(b) and rule 10b-5 are explicitly referred to by this Court as provisions evincing "duty-creating" language. *Id.* The Court indicated that despite the language of §10(b), it had, in *Superintendent of Insurance* v. *Bankers Life & Casualty,* 404 U.S. 6 (1977), acquiesced in the implication of a private right of action thereunder because of "the 25-year-old acceptance by the lower federal courts of a 10b-5 cause of action. *Cannon,* 99 S.Ct. at 1955 n. 13. In *Redington,* the Court repeated that in *Superintendent* it had "simply explicitly acquiesced" and indicated that such acquiescence would be unwarranted where "[t]here is no similar history of longstanding lower court interpretation." 99 S.Ct. at 2490 n. 19.

Because §17(a) of the Securities Act is virtually identical in language to §10(b) and rule 10b-5, it is clearly an enactment of the "duty-creating" kind. More than the barest reference to the general public in some capacity, such as "purchasers" or "security holders," is necessary to classify a provision as "right-creating." Rather, the enactment must evince "an unmistakable focus on the benefited class." *Cannon,* 99 S.Ct. at 1955. Furthermore, §17(a) has no longstanding history of implication of a private right of action. *See, e.g., Marbury Management, Inc.* v. *Kohn,* 470 F. Supp. 509, 514-15 n. 9 (S.D.N.Y. 1979); *Scarfarotti* v. *Bache & Co.,* 438 F. Supp. 199, 207 (S.D.N.Y. 1977); *Architectural League of New York* v. *Bartos,* 404 F. Supp. 304 (S.D.N.Y. 1975). The Eighth Circuit has held that no private right of action exists under §17(a) of the 1933 Act. *Shull* v. *Dain Kalman & Quail, Inc.,* 561 F. 2d 152 (8th Cir. 1977), *cert. den.* 434 U.S. 1086 (1978). *Contra, Newman* v. *Prior,* 518 F. 2d 97 (4th Cir. 1975); *Daniel* v. *International Brotherhood of Teamsters,* 561 F.2d 1223 (7th Cir. 1977), *reversed on other grounds,* 439 U.S. 551 (1979).

Accordingly, implication of a private right of action under §17(a) of the 1933 Act is not indicated by the statutory language, is not required to fulfill the intent of Congress, and is not warranted by any exceptional circumstances. In view of the conflict among several Circuits and the importance of the question, we urge the Court to grant certiorari to resolve the issue whether there is a private right of action under Section 17(a) of the 1933 Act. Absent resolution by this Court, the proliferation of lower federal court decisions dealing with §17(a) may create a situation where the Court will feel obliged to simply acquiesce in the lower courts' acceptance of an implied right of action without expressly considering the matter.

CONCLUSION

For these reasons, a writ of certiorari should be granted.

October 17, 1979.

Respectfully submitted,

Allen G. Schwartz,
Corporation Counsel of the
City of New York,
Attorney for Petitioners.

James G. Greilsheimer,
Bruce S. Kaplan,
Leonard Koerner,
Judith A. Levitt,
of Counsel.

Appendices

APPENDIX A

Opinion of Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 315—September Term, 1977

(Argued January 18, 1978 Decided November 30, 1978)

Docket No. 77-6104

ALFRED KIRSHNER,

Plaintiff-Appellant,

v.

UNITED STATES OF AMERICA, SECRETARY OF THE TREASURY, COMMISSIONER OF I.R.S., ALVIN D. LURIE, in his capacity as Assistant Commissioner, Employer Plans and Exempt Organizations, I.R.S., BERNARD GOLBERG, REUBEN MITCHELL, JOSEPH SHANNON, ROBERT CHRISTEN, VICTOR CONDELLO, HARRISON J. GOLDIN, JAMES REGAN, individually and as Trustees of the Teachers Retirement System of the City of New York, and ISAIAH ROBINSON,

Defendants-Appellees.

Before: MOORE, SMITH and MANSFIELD, *Circuit Judges.*

Action for injunctive and other relief brought by a beneficiary of a municipal pension fund against the trustees of the fund and others alleging violations of the federal securities laws, breach of fiduciary duty, and other

claims. The District Court for the Southern District of New York, Lawrence W. Pierce, *Judge,* dismissed the complaint in its entirety and entered judgment accordingly. The Court of Appeals held that plaintiff had standing to sue under the federal securities laws.

Affirmed in part, reversed in part and remanded for further proceedings.

Alfred Kirshner, *Appellant Pro Se.*

Kent T. Stauffer, Assistant U.S. Attorney (Robert B. Fiske, Jr., U.S. Attorney for the Southern District of New York, Patrick H. Barth, Assistant U.S. Attorney, of counsel), *for Appellees United States of America, Secretary of the Treasury, Commissioner of I.R.S., and Alvin D. Lurie.*

Leonard Koerner (W. Bernard Richland, Corporation Counsel, City of New York, James G. Greilsheimer, L. Kevin Sheridan and Judith A. Levitt, of counsel), *for Appellees, Trustees of Teachers Retirement System.*

Smith, *Circuit Judge*:

This is an appeal from a judgment dismissing an action brought by a beneficiary of a municipal pension fund against the trustees of the fund and others alleging deprivation of constitutionally protected rights, violations of the federal securities laws, and breach of fiduciary duty under state law and seeking injunctive, declaratory and other relief. The United States District Court for the Southern District of New York, Lawrence W. Pierce,

Judge, held that appellant lacked standing to sue under the federal securities laws, and dismissed the complaint in its entirety, entering judgment accordingly. We find that appellant has standing to sue under the federal securities laws, and reverse the dismissal as to the individuals sued as fund trustees.

For the purpose of this appeal from a judgment granting a motion to dismiss, we treat allegations of the complaint as admitted. *Drachman* v. *Harvey,* 453 F.2d 722, 724 (2d Cir. 1972), *Murray* v. *City of Milford,* 380 F.2d 468, 470 (2d Cir. 1967).

I.

The facts alleged may be summarized as follows.

Appellant, Alfred Kirshner, was employed as a high school science teacher by the Board of Education of the City of New York from 1928 to 1953. During these years he was obliged to contribute to the Teachers Retirement System of the City of New York ("the System") by means of compulsory payroll deductions credited to the System's annuity savings fund. The City of New York ("the City") was required to pay into the System's contingent reserve fund amounts sufficient to provide for a pension reserve at the time of his retirement. At Kirshner's retirement in 1953, accumulated deductions were transferred on the books of the System to the System's annuity reserve fund and an amount equal to the employee's pension reserve was transferred to the System's pension reserve fund number one. Since then he has received monthly retirement allowances consisting of an annuity and a pension. In 1976 his retirement allowances totaled $3,035.68.

The System is controlled by the Teachers Retirement Board ("the Board"). The Board has the power to purchase securities for and to sell securities held by any of the System's funds. The Board's seven members are trustees for the fund. Three are elected by active employees of the Board of Education. The concurrence of at least one of these three is necessary for any decision of the Board. Retired employees have no representative on the Board.

As of June 30, 1974, about a year before the beginning of the City's financial crisis, the System had $1.85 billion in assets and $4.62 billion in accrued liabilities. Apparently, amounts paid in by the City had not been enough to establish adequate pension reserves. Of the $1.85 billion in assets, $1.62 billion had been transferred into the annuity reserve fund or the pension reserve fund number one or successor funds. The remaining $0.23 billion was held in the annuity savings fund and the contingent reserve fund or their successor funds. Of the $4.62 billion in accrued liabilities, $1.62 billion was owed to reserves for retired employees and $3 billion was owed to reserves for active employees. Thus, there was only $0.23 billion set aside for pensions of active employees although the System had outstanding retirement obligations to these employees of $3 billion. Consequently, when the City's crisis began, the principal concern of retired employees was protecting the integrity of the System's annuity reserve fund and pension reserve fund, or successor funds, while the interests of the Board of Education's active employees lay in assuring that the City had funds to put into the System, so that the employees' retirement allowances

could be paid when they became due, and in seeing to it that the City was able to pay their salaries.

In June, 1975 the Legislature of the State of New York instituted the first of several steps in response to the City's financial plight. It established the Municipal Assistance Corporation for the City of New York ("MAC") "to assist the city of New York in providing essential services to its inhabitants . . . and in creating investor confidence in the soundness of the obligations of such city . . . ." 1975 N.Y. Laws, ch. 169 §3031. MAC was authorized to issue up to $3 billion in notes and bonds. It was to purchase and accept for exchange short-term obligations of the City. On September 9, 1975, the Legislature passed the New York State Financial Emergency Act for the City of New York ("the Emergency Act") which "authorized and directed" certain purchases of MAC bonds and declared these bonds "reasonable, prudent and proper investments for . . . all trustees and other fiduciaries . . . ." 1975 N.Y. Laws, ch. 870 §1. The System was obliged to purchase bonds in the principal amount of $250 million. On September 29, 1975, however, the Court of Appeals of the State of New York struck down that portion of the Emergency Act which "directed" pension fund trustees to invest in MAC bonds as violative of the constitution of the state. Nevertheless, on October 17, 1975, to enable the City to avoid default, the Board agreed to acquire MAC bonds in the principal amount of $150 million. Concurrence of Board members elected by active employees followed concessions to active employees in contract negotiations between the City and representatives of the active employees. Still the crisis deepened.

On November 15, 1975, the City defaulted on its maturing short-term obligations and declared a moratorium on all payments. Between August 21, 1975 and November 20, 1975, the Board purchased MAC bonds in the principal amount of $275 million for the System's funds.

On November 25, 1975 MAC, several commercial banks, and five City pension systems entered into an agreement ("the Agreement") pursuant to which the Board agreed to acquire City serial bonds in the principal amount of at least $860 million over a period of about 30 months. In addition on February 1, 1976 the Board agreed to exchange the MAC bonds held by the System for long-term MAC bonds bearing 6% interest per year.

The banks, according to the complaint, "while ostensibly acting as disinterested parties, while using their reputations for fiscal integrity and sound business judgment to induce the 'TRUSTEES' to purchase $860 million of NYC serial bonds, failed to make full disclosure of the fact that they had sold over $2 billion of their NYC short term notes in the previous year." The banks "fail[ed] to disclose the extent and dollar value of the City bonds held by them as assets and as trustee and fiduciary for clients, [thereby] concealing material facts that would affect an informed investment decision." It is further alleged that the members of the Board, when entering into the Agreement, "were well aware that buying NYC bonds at that time was wrongful because the City was insolvent. In April 1975 Standard & Poor had completely suspended rating NYC bonds. Moody's had downrated them to unsatisfactory Caa on November 3, 1975. . . . Not one bank, insurance company, investment company, trade union fund or corpo-

ration in the USA would at that time advance NYC any funds, but the 'TRUSTEES' volunteered to advance $860 million of the assets of the plaintiff . . . ." Moreover, the Board "accepted the reduced 6% rate on Moody-rated B (unsatisfactory) MAC bonds at a time when A's were selling with 8% to 9% returns at par."

The Agreement provided that the System's purchase of City bonds was contingent upon either the issuance of a ruling by the Internal Revenue Service ("IRS") or the enactment of federal legislation providing that the proposed purchases shall not constitute "prohibited transactions" within the meaning of § 503(b) of the Internal Revenue Code of 1954, as amended ("the Code"), or otherwise adversely affect the tax status of the System's pension funds under § 401(a) of the Code.

On December 4, 1975, the Board requested the IRS to rule that certain purchases of City serial bonds would not result in "prohibited transactions" or violate any provisions of § 401(a). However, it is alleged that "in their requests to IRS for approval [the Board] did not make full disclosure in five instances which indicate violations of Security Exchange laws and regulations 10(b) and Rule 10b-5." It did not disclose (1) that the banks had sold City obligations in the previous year; (2) that City serial bonds were to be purchased at par when available at a discount; (3) the purchases would increase fund holdings of City obligations "to 32%"; (4) the Board intended to sell sound corporate bonds to raise cash to make these purchases; (5) the purchases were not for the exclusive benefit of the beneficiaries.

Alvin D. Lurie, an Assistant Commissioner of the IRS, issued the requested rulings. Shortly thereafter, the Board allegedly sold "sound, liquid, varied, highly-rated corporate bonds" to buy "highly speculative, poorly rated, illiquid, high risk NY City obligations," and purchased "at par $182 million NYC serial bonds which were available at discounts [of approximately 20%]." These purchases "increased the [pension funds'] holdings of NYC obligations as of December 15, 1975 to 32%."

On February 1, 1976, pursuant to the Agreement, the System exchanged MAC bonds in the principal amount of $215 million for a like amount of long-term MAC bonds bearing interest at 6% per year. The bonds which it gave up were short-term obligations bearing interest at 11% per year.

In February, 1976 hearings were held on special federal legislation which would provide that parties to the Agreement would not be considered to violate § 401(a) or § 503(b) of the Code as a result of purchases or acquisition of MAC or City serial bonds. On March 19, 1976 Congress enacted Public Law 94-236 which granted such protection of all parties for all such purchases or acquisitions made on or after August 20, 1975.

By December 31, 1976 the Board had "increas[ed] the [funds'] holding[s] of NYC obligations to $782 million or 36% of total assets." The Board voted to acquire these bonds "[i]n order to maintain . . . contract benefits, full employment at high wages and high city pension contributions to benefit the presently employed teachers . . . ." As a result of the Board's actions, the assets of the pension funds have been "leached and dissipated." The "funds

are being used to pay off NYC bonds owned by the Clearing House Banks and their clients at the expense of the minority pensioners, including plaintiff."

Under the Agreement, the Board was obliged to purchase additional City serial bonds in the principal amount of $504 million by June 30, 1978, "making 51% of [the System's] assets NYC obligations . . . ."

II.

In February, 1977, Kirshner *pro se* commenced the instant action against the United States of America, the Secretary of the Treasury, the Commissioner of the Internal Revenue Service, Alvin D. Lurie in his capacity as Assistant Commissioner of the Internal Revenue Service, and named members of the Board, individually and as trustees of the System's funds.

In his complaint, in addition to the facts alleged above, Kirshner claims that "the 'TRUSTEES' intent to manipulate and deceive was expressly indicated by the 'AGREEMENT.'"

He maintains that "[t]he 'AGREEMENT' was tainted by fraud by 'concealing material facts to which importance could be attached that would affect informed investment decision,'" and states that the Agreement "was not made at arms length." The conduct of the members of the Board, Kirshner contends, violates § 17(a) of the Securities Act of 1933 ("the 1933 Act"), 15 U.S.C. § 77q, § 10(b) of the Securities Exchange Act of 1934 ("the 1934 Act"), 15 U.S.C. § 78j(b) and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, and constitutes a breach of fiduciary duty under state law. In addition, Kirshner alleges that

federal and state appellees have deprived him and other retired employees of constitutional rights granted by article I, § 10 and by the fifth and fourteenth amendment to the Constitution of the United States, and that Public Law 94-236 is unconstitutional.

As relief Kirshner seeks a declaration that Public Law 94-236 is unconstitutional and an injunction preventing its application, an order setting aside the alleged IRS rulings, an order prohibiting the Board members from purchasing additional City obligations, another order requiring them to exchange the MAC bonds bearing 6% interest for those purchased initially, and, finally, restitution for all losses incurred as a result of entering into and carrying out the terms of the Agreement.

Appellees moved separately to dismiss Kirshner's complaint for lack of jurisdiction over the subject matter and for failure to state a claim upon which relief can be granted. Kirshner cross-moved for a preliminary injunction. The district court, holding that Kirshner lacked standing to sue under the federal securities laws, granted the motions to dismiss and denied the cross-motion as moot. Kirshner appealed from the district court's order and we assumed jurisdiction.[1]

III.

We agree with the district court that no basis is stated for the action against the United States and the federal

1. The judgment entered below dismissed the complaint, but not the action. Appellees have not raised this issue on appeal. However, under 28 U.S.C. § 1292, jurisdiction may be predicated upon the district court's denial of appellant's cross-motion for a preliminary injunction.

officials. That claim is based on Public Law 94-236 and on the IRS ruling that the contemplated transactions would not constitute "prohibited transactions" which would deprive the securities of their tax-exempt status under the federal statutes. We fail to see in the claim any harm to the plaintiff or the funds, or any basis for the plaintiff's standing to challenge the ruling.

Kirshner makes a constitutional claim of impairment of the obligation of contract. But while his pension rights arise from a contract,[2] his claims of impairment must fail. Article I, § 10 of the Constitution of the United States declares that "[n]o State shall . . . pass any . . . Law impairing the Obligation of Contracts . . . ." This prohibition, however, "is not an absolute one and is not to be read with literal exactness like a mathematical formula." *Home Building & Loan Ass'n* v. *Blaisdell,* 290 U.S. 398, 428 (1934). A state may take necessary measures in pursuit of legitimate state goals without bar by the contract clause even though some contract rights may to some degree be modified or affected. *City of El Paso* v. *Simmons,* 379 U.S. 497 (1965); *Home Building & Loan Ass'n* v. *Blaisdell, supra,* 290 U.S. at 398; *Koch* v. *Yunich,* 533 F.2d 80, 86 (2d Cir. 1976). The protection of the fiscal integrity of the City of New York is such a legitimate state goal. The Board's members are authorized by state law to invest in both MAC and City serial bonds. Administrative Code of the City of New York, ch. 20 § 1320.31.0; N.Y. Public Authorities Law § 3018 (McKinney Supp. 1970-77); N.Y. Banking Law

2. The Constitution of the State of New York, article V, § 7 provides that after May 1, 1940, membership in any pension or retirement system of a civil division of the state "shall be a contractual relationship, the benefits of which shall not be diminished or impaired."

§ 235(4) (McKinney 1971); *Tron* v. *Condello,* 427 F. Supp. 1175, 1187-88 (S.D.N.Y. 1976). These state laws appear to be necessary to a valid state purpose—protecting the fiscal integrity of the City by broadening the available markets for its securities—and therefore not in contravention of article I, § 10 of the Constitution.

Kirshner's constitutional claim of deprivation of property without due process also affords him no relief. The federal and state enactments pursuant to which the challenged actions were carried out are rationally related to lawful governmental objectives and are not unreasonable, arbitrary or capricious. Assuming, *arguendo,* that Kirshner has a constitutionally protected property right, see *Board of Regents* v. *Roth,* 408 U.S. 564, 577 (1972); *Tron* v. *Condello, supra,* 427 F. Supp. at 1189; *Robbins* v. *Police Pension Fund,* 321 F. Supp. 93, 97 (S.D.N.Y. 1970), he cannot be said to have been deprived of that right without substantive or procedural due process. See generally *Nebbia* v. *New York,* 291 U.S. 502, 525 (1934); *Koch* v. *Yunich, supra,* 533 F.2d at 84. Nor has Kirshner been denied equal protection of the laws by either the federal or state enactments, for he has not demonstrated any arbitrary or unreasonable classification in the statutes. See *Reed* v. *Reed,* 404 U.S. 71, 76 (1971).

Kirshner's claim that Public Law 94-236 and the IRS rulings violate the fifth and fourteenth amendments is likewise without merit. Their effect is solely to remove any question as to the tax exempt status of the securities involved and could only benefit, rather than damage, the City and its creditors. The district court was correct in dismissing appellant's constitutional claims.

The situation is different, however, as to the Securities Acts claims against the non-federal defendants. We are concerned at this point only with whether Kirshner has alleged facts sufficient to give him standing to sue under the securities laws and to form a basis for relief if liability is established on trial. We, of course, intimate no opinion as to the truth of his allegations. The court below, citing *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975), held that Kirshner lacks standing to assert a private cause of action under § 10(b) of the 1934 Act, 15 U.S.C. § 78j(b)[3] and Rule 10b-5, 17 C.F.R. § 240.10b-5,[4] promulgated thereunder. We disagree. To be sure, in *Birnbaum* v. *Newport Steel Corp.,* 193 F.2d 461 (2d Cir.), *cert. denied,* 343 U.S. 956 (1952), affirming dismissal of a derivative action against a director for violation of § 10(b)

3. Section 10(b) of the 1934 Act makes it

> unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

4. Rule 10b-5 reads:

> Employment of manipulative and deceptive devices.
>
> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (1) To employ any device, scheme or artifice to defraud,
>
> (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

where the director had sold his shares in the corporation to an outside purchaser, we stated that § 10(b) and Rule 10b-5 "extended protection only to the defrauded purchaser or seller," *id.* at 464.

Since its promulgation in 1952, the *Birnbaum* rule has been adhered to consistently in this circuit; see *International Controls Corp.* v. *Vesco,* 490 F.2d 1334, 1346 n. 16 (2nd Cir.), *cert. denied,* 417 U.S. 932 (1974). We have, however, recognized that a shareholder who has not purchased or sold shares may bring a derivative action under § 10(b) against corporate insiders on behalf of the defrauded corporation if the corporation has bought or sold securities. *Schoenbaum* v. *Firstbrook,* 405 F.2d 215, 219 (2d Cir. 1968), *cert. denied sub nom. Manley* v. *Schoenbaum,* 395 U.S. 906 (1969); *Ruckle* v. *Roto American Corp.,* 339 F.2d 24, 27-28 (2d Cir. 1964). And in approving the *Birnbaum* rule in *Blue Chip Stamps* v. *Manor Drug Stores, supra,* 421 U.S. 723, the Court took cognizance of this interpretation of the rule, *id.,* at 948-49.

We think the beneficiary of a pension trust, like the shareholder in a derivative suit, has standing to attack securities frauds perpetrated or threatened by the trustees of his fund. A number of courts have taken the view that a trust beneficiary may sue under Rule 10b-5. See, *e.g.,* James v. *Gerber Products Co.,* 483 F.2d 944 (6th Cir. 1973); *Heyman* v. *Heyman,* 356 F. Supp. 958 (S.D.N.Y. 1973). Treating the allegations of the *pro se* complaint liberally as we must under *Haines* v. *Kerner,* 404 U.S. 519 (1972), it would appear that purchase and sale of securities is sufficiently involved, see *Superintendent of Insurance* v. *Bankers Life & Casualty Co.,* 404 U.S. 6 (1971), and that the plaintiff has

also alleged the knowledge and intent to defraud required by *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976).[5]

The court below also held that Kirshner has no claims under § 17a of the 1933 Act, 15 U.S.C. § 77q, because no private cause of action is recognized under this section. We disagree with this conclusion. See *Daniel* v. *International Bhd. of Teamsters,* 561 F.2d 1223, 1244-46 (7th Cir. 1977), *cert. granted,* 46 U.S.L.W. 3512 (Feb. 21, 1978).[6] We left the question open in *Globus* v. *Law Research Service, Inc.,* 418 F.2d 1276, 1283-84 (2d Cir. 1969), *cert. denied,* 397 U.S. 913 (1970), noting, however, Judge Friendly's remark concurring in *SEC* v. *Texas Gulf Sulphur Co.,* 401

5. The dissent evidences concern that the provisions of the Employee Retirement Security Act of 1974 (ERISA), particularly requirements concerning disclosure, preclude a cause of action under the Securities Acts in this case. We believe that this concern is misplaced. First, it is not at all clear that the specific requirements of ERISA preclude actions under the broader requirements of the Securities Acts. See *Daniel* v. *International Bhd. of Teamsters,* 561 F.2d 1223, 1248 (7th Cir. 1977), *cert. granted,* 46 U.S.L.W. 3512 (Feb. 21, 1978). (ERISA should be read as "complementary" to the anti-fraud provisions of the Securities Acts.) Second, the cause of action here does not stem from a specific duty to disclose on the part of the trustees. In addition to a general duty of disclosure, *James* v. *Gerber Products Co.,* 483 F.2d 944 (6th Cir. 1973), plaintiff's complaint, read liberally, alleges a conspiracy to defraud in violation of Rule 10b-5, which is in no way tied to a specific duty of disclosure. See *Ferguson* v. *OmniMedia,* 469 F.2d 194 (1st Cir. 1972); *Herpich* v. *Wilder,* 430 F.2d 818 (5th Cir. 1970), *cert. denied,* 401 U.S. 947 (1971).

6. See also, *Newman* v. *Prior,* 518 F.2d 97 (4th Cir. 1975); *Surowitz* v. *Hilton Hotels Corp.,* 342 F.2d 596 (7th Cir. 1965); *Wulc* v. *Gulf & Western Ind.,* 400 F. Supp. 99 (E.D. Pa. 1975); *contra, Shull* v. *Dain, Kalman & Quail, Inc.,* 561 F.2d 152 (8th Cir. 1977); *Scarfaretti* v. *Bache & Co.,* 438 F. Supp. 199 (S.D.N.Y. 1977); *Gunter* v. *Hutcheson,* 433 F. Supp. 42 (D. Ga. 1977); *Architectural League of New York* v. *Bartos,* 404 F. Supp. 304 (S.D.N.Y. 1975); *Welch Foods* v. *Goldman Sachs,* 398 F. Supp. 1393 (S.D.N.Y. 1974).

F.2d 833, 867 (2d Cir. 1968), that there was little practical point in denying the existence of an action under § 17 once it is established that an aggrieved buyer has a private action under § 10(b) of the 1934 Act.

We agree with the Seventh Circuit that the language of § 17 is broad enough to imply a private right of action and that the beneficiaries of the trust are persons claiming injury for the alleged fraud in purchase and sale of securities.

Kirshner has standing, as a beneficiary of the fund, to bring this action on behalf of the fund against those alleged to have defrauded the fund in its purchase of securities, and the complaint may be interpreted to charge participation by these defendants in fraudulent sale of securities by and to the fund.

The district court dismissed Kirshner's state law claims for breach of fiduciary duty. Since Kirshner states a claim under § 10(b) and § 17, on remand he may assert his pendent state claims. *United Mine Workers* v. *Gibbs,* 383 U.S. 715 (1966). Of course, as we have said, we intimate no opinion as to the merit of any of the claims.

Judgment reversed. Dismissal of Rule 10b-5 and § 17 claims and pendent state law claims reversed. Dismissal of other claims affirmed. Case remanded for proceedings not inconsistent with this opinion.

Moore, *Circuit Judge* (Dissenting):

I would affirm, largely for the reasons set forth in Judge Pierce's well-reasoned opinion.

Plaintiff is the recipient of a pension from the New York City Teachers' Retirement System. He retired in 1953 and since then has been on a pension—$3,000 a year. There is no allegation that any of the acts complained of have caused his pension to cease or payments to have been diminished. Indeed, paragraph 9b of his complaint reveals that he is unable to allege any injury to his interests because his retirement account was fully funded at the time of his retirement and apparently has remained fully funded up to this day. Furthermore, his actuarial calculations show that his expectant lifetime pension is $39,000; the $1.6 billion in the Funded Assets Account of the Retirement System amounts to $64,600 for each retiree, more than enough to fund his expected pension. Hence, Kirshner has not been injured by the acts complained of. *See Association of Data Processing Service Organizations, Inc.* v. *Camp,* 397 U.S. 150 (1970).

Not only has Kirshner failed to allege facts to support his standing to sue, but also, as appears from Judge Pierce's opinion, he has failed to state a cause of action on his non-securities law claims. The gravamen of his complaint is that certain investments in New York City bonds made recently, at a time when the City was in dire financial straits, were improvident. In view of the prominence given to the City's financial plight in the public press, I am willing to take judicial notice that investment in its securities would be highly questionable. However, in addition to the many

burdens placed upon the judiciary, I am unwilling to add that of investment counsel to an employees pension fund to the list. Support for this position is found in a decision of New York's highest court in *Sgaglione* v. *Levitt,* 37 N.Y.2d 507 and in Judge Conner's decision in *Tron* v. *Condello,* 427 F.Supp. 1175 (S.D.N.Y. 1976). Whatever relief, if any, to which plaintiff may be entitled may be had through the state courts where breach of fiduciary duty may be asserted and equitable relief and damages, if any, awarded.[1]

The majority opinion supports most of Judge Pierce's decision and disagrees only with his treatment of Kirshner's securities law claims. Even if Kirshner has standing to bring this action, as the majority finds he does, his complaint should still be dismissed for failure to state a cause of action under §10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. §78j(b), and §17 of the Securities Act of 1933, 15 U.S.C. §77q. In my opinion, the majority's holding that the complaint states a cause of action under §10(b) and §17 constitutes an ill-advised extension of the reach of the antifraud provisions of the securities laws as they have been applied to allegations of corporate mismanagement.[2]

There has been a tendency over recent years to rely upon various sections of the Security Exchange laws to

1. The availability of a state court remedy for breaches of fiduciary duty and the traditional role of state law in regulating trust fund fiduciaries add additional support to my belief, explained later in the text, that Kirshner has failed to state a cause of action under §10(b). *See Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462, 478 (1977).

2. *See Santa Fe Industries* v. *Green,* 430 U.S. 462, 475 n.15 (1977) and the cases cited therein; Jacobs, *How Santa Fe Affects 10b-5's Proscriptions Against Corporate Mismanagement,* 6 Sec. Reg. L.J. 3 (1978).

create causes of action by the recital of section numbers such as §10(b), Rule 10-b(5) and §17, as if the mere recital had a talismanic effect and would bring some kind of a triable action into being.

The private cause of action under §10(b) was created by federal courts in order to effectuate congressional policies arguably embodied in the securities legislation passed in 1933 and 1934. Thus the broad extension of the private §10(b) action has not been mandated by Congress; it is rather a matter of the courts seeking to erect a rational enforcement system on a very shaky base. However, a rational enforcement system ought to take into account the latest efforts of Congress to regulate retirement trust fund managements. In the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. §§1001-1381, Congress has established detailed and complex rules to control pension fund managers. In pertinent part, ERISA provides that pension fund trustees have a duty of undivided loyalty to the beneficiaries, 29 U.S.C. §1104, and regulates the extent to which a pension fund can hold securities issued by the employer, 29 U.S.C. §§1106-1107. ERISA contains complex disclosure and reporting requirements, but nowhere does it require that trustees must disclose in advance to the beneficiaries their proposed investment transactions, 29 U.S.C. §§1021-1026. If Congress had wanted to require pension fund trustees to disclose investment transactions, Congress would have enacted such a rule. Although this case involves a public employee pension fund, the majority's holding that a pension beneficiary has a cause of action against the trustee is equally applicable to private pension

funds which are covered by ERISA. Moreover, since Congress has elected not to burden municipal employee pension funds with ERISA's requirements, 29 U.S.C. §1003, a federal court should not create a new disclosure duty on the dubious foundation of §10(b) and apply it to public employee pension funds in this case. I would find that Kirshner's complaint has not stated a federal cause of action upon which relief can be granted.

In short, I believe that Judge Pierce has correctly analyzed the amended complaint (and the law applicable thereto) and found it wanting. With that analysis I concur and hence would affirm.

APPENDIX B

Order Denying Petition for Rehearing En Banc

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the nineteenth day of July, one thousand nine hundred and seventy-nine.

ALFRED KIRSHNER,

Plaintiff-Appellant,

v.

UNITED STATES OF AMERICA, SECRETARY OF THE TREASURY, COMMISSIONER OF I.R.S., ALVIN D. LURIE, in his capacity as Asst. Commissioner Employer Plans & Exempt Organizations; I.R.S., BERNARD GOLDBERG, REUBEN MITCHELL, JOSEPH SHANNON, ROBERT CHRISTEN, VICTOR CONDELLO, HARRISON GOLDEN, JAMES REGAN, Individually as Trustees of Teachers Retirement System of City of New York and ISAAH ROBINSON, Individually as former trustee,

Defendants-Appellees.

A petition for rehearing containing a suggestion that the action be reheard en banc having been filed herein by

counsel for certain of the appellees, and no active judge or judge who was a member of the panel having requested that a vote be taken on said suggestion,

Upon consideration thereof, it is

Ordered that said suggestion be and it hereby is DENIED.

/s/ IRVING R. KAUFMAN

IRVING R. KAUFMAN, Chief Judge

Order Denying Petition for Rehearing

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the nineteenth day of July, one thousand nine hundred and seventy-nine.

Present:

HON. WALTER R. MANSFIELD
HON. LEONARD P. MOORE
HON. J. JOSEPH SMITH
Circuit Judges.

ALFRED KIRSHNER,

Plaintiff-Appellant,

v.

UNITED STATES OF AMERICA, SECRETARY OF THE TREASURY, COMMISSIONER OF I.R.S., ALVIN D. LURIE, in his capacity as Asst. Commissioner Employer Plans & Exempt Organizations; I.R.S., BERNARD GOLDBERG, REUBEN MITCHELL, JOSEPH SHANNON, ROBERT CHRISTEN, VICTOR CONDELLO, HARRISON GOLDEN, JAMES REGAN, individually as Trustees of Teachers Retirement System of City of New York and ISAAH ROBINSON, Individually as former trustee,

Defendants-Appellees.

Appendix B

A petition for a rehearing having been filed herein by counsel for certain of the appellees,

Upon consideration thereof, it is

Ordered that said petition be and hereby is DENIED.

A. Daniel Fusaro, Clerk

/s/ SARA PIOVIA
Sara Piovia
Deputy Clerk

Appendix B

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 315—September Term, 1977

(Petition for rehearing filed January 4, 1979 — Decided July 19, 1979)

Docket No. 77-6104

ALFRED KIRSHNER,

Plaintiff-Appellant,

v.

UNITED STATES OF AMERICA, SECRETARY OF THE TREASURY, COMMISSIONER OF I.R.S., ALVIN D. LURIE, in his capacity as Assistant Commissioner, Employer Plans and Exempt Organizations, I.R.S., BERNARD GOLDBERG, REUBEN MITCHELL, JOSEPH SHANNON, ROBERT CHRISTEN, VICTOR CONDELLO, HARRISON J. GOLDIN, JAMES REGAN, individually and as Trustees of the Teachers Retirement System of the City of New York, and ISIAH ROBINSON,

Defendants-Appellees.

Before: MOORE, SMITH and MANSFIELD, *Circuit Judges.*

On Petition for Rehearing

SMITH, *Circuit Judge*:

The appellee-trustees have filed a petition for rehearing in light of the Supreme Court's recent decision in *Inter-*

national Brotherhood of Teamsters v. *Daniel,* 47 U.S.L.W. 4135 (Jan. 16, 1979). This case, however, does not involve the issues decided in *Daniel,* which held that an interest in a non-contributory, compulsory pension plan is not a security within the meanng of § 2(1) of the Securities Act of 1933, 15 U.S.C. § 77b(1), or § 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10). Kirshner does not claim that his pension interest under the System is a security. He contends rather that fraud was perpetrated by the trustees in connection with the fund's purchase of MAC and NYC bonds, which the trustees cannot and do not contend are not securities. Thus Kirshner merely is suing derivatively as a trust beneficiary to attack the fraud allegedly perpetrated upon the fund by the trustees in connection with the purchase of these securities. *See, Kirshner* v. *United States,* —— F.2d ——. ——————, slip op. 5327, 5249-50 (2d Cir. Nov. 30, 1978).

Daniel also has no effect on our conclusion that a private right of action exists under § 17a of the 1933 Act, 15 U.S.C. § 77q, since the Court found it unnecessary to reach that issue. 47 U.S.L.W. at 4136 n. 9.

The petition for rehearing is denied.

Moore, *Circuit Judge* (Concurring):

On January 16, 1979 we affirmed by order Judge Conner's opinion in *Withers* v. *Teachers Retirement System,* 447 F.Supp. 1248 (SDNY, 1978), *aff'd by order,* Dkt. 78-6059 (Jan. 16, 1979). Judge Conner considered at length all of the facts which underlie Kirshner's allegations. He found that the Teachers Retirement System Trustees had not breached their fiduciary duties to the TRS beneficiaries. It is unlikely that Kirshner will be able to prove that the Trustees have violated the securities laws.

Since Kirshner will have to establish at trial that the Trustees did breach their fiduciary duties, overcoming at least the *stare decisis* effect of *Withers,* I think that a rehearing at this time would be a waste of judicial energy.

APPENDIX C

Opinion of District Court

Lawrence W. Pierce, D.J.

MEMORANDUM AND ORDER

Plaintiff Alfred Kirshner brings this action seeking an injunction against certain investments made in securities of the Municipal Assistance Corporation by the defendant Trustees of the Teachers' Retirement System of the City of New York ("the Trustees"). Plaintiff also seeks judicial review of the actions of the Internal Revenue Service implementing special legislation passed by Congress, PL 94-236 (March 19, 1976), which statute permitted the Trustees to make the investments challenged herein without risking the loss of the System's tax exempt status. Finally, Kirshner seeks a declaratory judgment that PL 94-236 is unconstitutional and seeks an injunction barring its enforcement.

Plaintiff is a retired New York City school teacher, and he alleges a vested right in his $3,000 annual pension. The gravamen of the amended complaint is the claim that the investments made by the Trustees and approved by the IRS have and will continue to jeopardize plaintiff's interest in the financial integrity of the billion-dollar funded assets of the retirement system. Plaintiff has moved for a preliminary injunction; the defendants have moved to dismiss the complaint for failure to state a claim upon which relief could be granted. The motions to dismiss are granted.

The amended complaint alleges that jurisdiction is present pursuant to 28 U.S.C. §1331 and 1343, as well as pursu-

ant to the Administrative Procedure Act, 5 U.S.C. §702. It is claimed that the actions of the defendant Trustees have violated 42 U.S.C. §1983 by depriving plaintiff of his constitutional rights under the contract clause, Art. I, Section 10, and under the due process and equal protection clauses of the fourteenth amendment. The Trustees are also said to have violated Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934, as well as Rule 10b-5 thereunder. Finally, the Trustees are charged with breach of fiduciary duty.

As against the defendant the United States, its agencies and its officers, plaintiff seeks review of administrative action, and a declaratory judgment pursuant to 28 U.S.C. §2201 that PL 94-236 is unconstitutional; plaintiff further seeks an injunction enforcing two provisions of the Internal Revenue Code, 26 U.S.C. §§401 and 403, which allegedly would bar the purchases at issue if not for the enactment of PL 94-236. Finally, plaintiff claims that the federal defendants have deprived him of due process in violation of the fifth amendment and of his contract rights under the contract clause; he also claims that the federal officials have violated the securities laws.

This action is not the first to raise a constitutional attack against the investment policies of New York City employee retirement pension funds. See *Sgaglione* v. *Levitt,* 37 N.Y.2d 507, 337 N.E.2d 592, 375 N.Y.S.2d 79 (1975); *Withers* v. *Teachers' Retirement System,* 76 Civ. 4474 (S.D.N.Y. Dec. 22, 1976); *Tron* v. *Condello,* 427 F.Supp. 1175 (S.D.N.Y. 1976). These cases have carefully considered the facts and the law as it applies to this matter; thus many of the claims made here are capable of summary disposition

based upon precedent which this Court finds highly persuasive.

Plaintiff's claim that the actions of the defendants violate the contract clause, Art. I, Section 10, must be dismissed for failure to state a claim. That provision grants to plaintiff no right to seek judicial review of the investment decisions of the Trustees. See *Sgaglione, supra; Tron* v. *Condello, supra,* 427 F.Supp. at 1188-89.

The same conclusion must be reached with respect to plaintiff's due process claims. While plaintiff may well have a vested property interest in his pension, he has no right to regulate the investment policies of the defendants. *Tron* v. *Condello, supra,* 427 F.Supp. at 1189-90. As Judge Conner observed in that case, to the extent plaintiff claims breach of fiduciary duty, that claim is cognizable in state court.

Kirshner makes an equal protection argument not raised in *Tron,* to wit, that the actions of the Trustees have discriminated against retired teachers while continuing to favor presently employed teachers. The Court concludes that this claim must similarly be dismissed for failure to state a claim, since it is but another method whereby plaintiff seeks to overturn the discretionary investment decisions made by the Trustees. See *Sgaglione, supra; Tron* v. *Condello, supra.* Indeed, even if plaintiff's equal protection argument were not foreclosed by the thrust of the state and federal decisions cited above, the claim must fall since the investment decisions of the Trustees have a rational basis and since the distinction between present and retired teachers is not a distinction which would be subjected to strict judicial scrutiny. Rather, under the "relatively re-

laxed standard" of judicial review, it is apparent that the actions of the Trustees bear a rational relationship to a legitimate state goal, i.e., the protection of the fiscal integrity of the City of New York. See generally *Massachusetts Board of Retirement* v. *Murgia,* 427 U.S. 307, 314 (1976) (*per curiam*); *Dandridge* v. *Williams,* 397 U.S. 471, 485 (1970). Accordingly, each of the three constitutional claims brought against the Trustees must be dismissed for failure to state a claim.

Nor do plaintiff's claims under the federal securities laws state a claim. It is undisputed that Kirshner was not a purchaser or a seller of the securities in issue. Thus he has no standing to assert a private cause of action under Section 10(b) or under Rule 10b-5. *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975). Further, plaintiff has no claim under Section 17(a) of the Securities Act since there exists no private cause of action based upon that statute. See *Welch Foods, Inc.* v. *Goldman Sacks & Co.,* 398 F.Supp. 139 (S.D.N.Y. 1974). Accordingly, all federal claims asserted against the Trustees must be dismissed. The pendent state law claims for breach of fiduciary duty must similarly be dismissed without prejudice to their assertion in a state court action. *United Mine Workers* v. *Gibbs,* 383 U.S. 715, 725 (1966).

Plaintiff seeks review of the actions of the federal defendants pursuant to the Administrative Procedure Act, 5 U.S.C. §702. In order to seek review under that section, the plaintiff must be a "person aggrieved" by agency action. *Id.* A possible financial loss is not itself a sufficient interest to sustain a judicial challenge to agency action. *Abbott Laboratories* v. *Gardner,* 387 U.S. 136, 153

(1967). The agency action challenged here is the approval by an Internal Revenue Service Assistant Commissioner of the investment plans of the Trustees. The agency did not mandate the investment; it simply ruled that the investments would not jeopardize the retirement fund's tax-exempt status. This action is so many levels removed from the interest asserted by the plaintiff that the Court is unable to conclude that Kirshner has standing to challenge it. The A.P.A. does not confer standing upon any person who might suffer financial loss as a result of agency action; rather, the action must directly violate plaintiff's vested legal rights. See *Harrison-Halsted Community Group, Inc.* v. *Housing and Home Finance Agency,* 310 F.2d 99, 104 (7th Cir. 1962), cert. denied, 373 U.S. 914 (1963). Plaintiff's "unadorned speculation" that the agency action will result in a direct injury to him is insufficient to confer jurisdiction under the A.P.A., or indeed, under the Constitution's Article III, Section 2 generally. See *Simon* v. *Eastern Kentucky Welfare Rights Organization,* 426 U.S. 26, 44 (1976); *Warth* v. *Seldin,* 422 U.S. 490, 505 (1975). Further, plaintiff's other federal claims against the federal defendants are defective for the same reasons that they fail to state a federal claim against the Trustees.

Even if the Court were to proceed to the merits of plaintiff's claim that PL 94-236 is unconstitutional, it is clear that the attack must fail. The statute cannot violate the contract clause, since that section applies to state legislation, not to the enactments of Congress. *New York* v. *United States,* 257 U.S. 591, 602 (1922). The due process claim must fall since, for the reasons stated earlier,

Kirshner has no vested property right in controlling the investment decisions of the Trustees. Nor is plaintiff deprived of any property right by reason of the alleged retroactive application of PL 94-236, since the law merely continued the tax exempt nature of the retirement fund, and since the retroactive period was sufficiently short to effect only the then-current fiscal year of the Teachers' Retirement System. Such a brief retroactive application does not serve to invalidate an income tax statute. See *United States* v. *Hudson,* 299 U.S. 498, 500-01 (1937). Accordingly, the due process attack on PL 94-236 must fall.

Under the cases cited previously, plaintiff's equal protection attack upon PL 94-236 must fail since the legislation has a reasonable relationship to the legislative goal, i.e., the fiscal preservation of the City of New York. See, e.g., the legislative findings set forth in the New York Seasonal Financing Act of 1975, 31 U.S.C. §1501. Further, the classification between present and retired teachers is not one which requires strict scrutiny of the Congressional action. See *Massachusetts Board of Retirement, supra;* cf. *Christian Echoes National Ministry, Inc.* v. *United States,* 470 F.2d 849, 857 (10th Cir. 1972), *cert. denied,* 414 U.S. 864 (1973).

For the foregoing reasons, it is apparent that plaintiff's complaint fails to state any federal claim upon which relief can be granted. Even under the less stringent standard applied to *pro se* complaintis, it appears "beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitled him to relief." *Conley* v. *Gibson,* 355 U.S. 41, 45-46 (1957); see *Haines* v. *Kerner,*

404 U.S. 519 (1972) (*per curiam*). The motions to dismiss are hereby granted. Plaintiff's cross-motion for a preliminary injunction is denied as moot. The complaint is dismissed.

So Ordered.

Dated: New York, New York
June 13, 1977

/s/ L. W. Pierce

Lawrence W. Pierce
U.S.D.J.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-640

BERNARD GOLDBERG, REUBEN MITCHELL, JOSEPH SHANNON, ROBERT CHRISTEN, VICTOR CONDELLO, HARRISON J. GOLDIN, JAMES REGAN, individually and as Trustees of the Teachers' Retirement System of the City of New York and ISAIAH ROBINSON, individually as former Trustee of the Teachers' Retirement System,

Petitioners,

v.

ALFRED KIRSHNER,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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Petitioners,

v.

ALFRED KIRSHNER,

Respondent.

BRIEF IN OPPOSITION
TO PETITION FOR CERTIORARI

REASONS FOR DENYING THE WRIT

The Second Circuit has neither expanded nor embellished this Court's decision in Blue Chip Stamps v. Manor Drug Stores, 421 U.S. (1975) by permitting Respondent, a beneficiary of a municipal pension fund, to proceed by

way of a derivative suit against Trustees of the fund under the anti-fraud provisions of the Federal Securities Laws [§17(a) of the Securities Act of 1933, 15 U.S.C. §77q, §10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b) and Rule 10 b-5 promulgated thereunder, 17 C.F.R. §240. 10 b-5] as well for breach of fiduciary duties under pendant state law.

The New York City Teachers Retirement System ("System") from which Respondent, a retired school teacher, receives a fixed annual allowance is funded by compulsory employer-employee contributions and income derived through the investment of those funds. Upon Respondent's retirement the total sum of his pension fund contributions plus accrued interest was immediately

transferred to the System's Annuity Reserve Fund. The total sum of the employer's compulsory contribution was simultaneously placed in the System's Pension Reserve Fund #1. These transactions fully fund Respondent's pension account, and, no further contributions are required during Respondent's lifetime.

These fixed funds are managed exclusively by the Trustees who are vested with the power to buy and sell securities. Three of the seven are active teachers. The retirees, some 25,000 in number, have no representation (4A)* and, as the Circuit Court held, the interests of the active and retired employees in the System's fund conflict. (4A-5A)

*Reference denoted by letter "A" refers to Appellant's appendices.

The two fixed funds had been totally invested in high grade bonds when the City faced its "serious financial crises" (App.Br.p.7). The Trustees sold these high grade bonds at a loss of $204 million** and, commencing in 1975, purchased New York City Serial Bonds and MAC Bonds poorly rated and in many instances above the market price. At present 46% of the total assets of the two fixed funds from which respondent and other retirees derive their pension income is invested in New York City securities.

The City of New York is required to repay this $204 million loss and is doing so by making payments to the active teachers' Contingency Reserve

**$51 million is attributable to the Annuity Reserve Fund.

Fund with the result that Respondent's pension funds (Annuity Reserve Fund and Pension Reserve Fund #1) must still bear 100% of the loss. Under these circumstances the funds which Respondent and other retired teachers must rely upon for their pensions can no longer be described as "fully funded" as they are required to be. Thus, in the event that New York City becomes bankrupt, (unfortunately, a not remote possibility) the decline in the System's fixed assets and the negligible recovery value of the New York City and MAC Bonds, 46% of Respondent's funds fixed assets, make it mathmatically improbable that Respondent or other retirees would receive full pensions for their actuarily expectant lifetimes.

Respondent, in contributing to the pension, relied on the contractual representation that upon his retirement those sources from which his pension is paid would be fully funded. By wrongfully invading principal, the Trustees have jeopardized, if not wholly impaired, Respondent's ability to receive the fixed compensation to which he is entitled. For these reasons the Second Circuit stated:

> "We think the beneficiary of a pension trust, like a shareholder in a derivative suit, has standing to attack securities frauds perpetrated or threatened by the trustees of his fund.(14A)

It is also logical to conclude that the Second Circuit, under the facts alleged, found it unnecessary to determine whether Respondent's interest in this compulsory contributory pension plan was or was not a security.(26A)

The trust has been impaired as a result of securities violations committed by the Trustees in connection with the purchase and sale of securities. A trust beneficiary is left with little recourse except to sue derivatively to redress the wrongs occasioned by these violations.

The Actionable Nondisclosure

In effectuating the purchase of New York City and MAC Bonds it was incumbent that the Trustees obtain and IRS ruling that these purchases would not constitute "prohibited transactions within the meaning of §503(b) of the Internal Revenue Code of 1954, as amended...or otherwise adversely affect the tax status of the System's pension funds and §401(a) of Code." (7A) Respondent alleges that in seeking IRS approval the Trustees,

in five instances,***failed to disclose material facts, which, if disclosed, would have denied the Trustees the right to purchase the New York City securities.

Respondent alleged, and the Second Circuit agreed, (14A-15A) that the failure of the Trustees to make full disclosure of all material facts to IRS enabled them to purchase the New York City securities. Such nondisclosure, if proven, constitutes a violation of the Federal Securities Laws and entitles respondent, as a beneficiary of the funds to sue derivatively for such violations.(1)

***The five instances are forth on page 7A. By June 30, 1978 some 51% of the Systems assets were in New York City obligations.

1. WHILE RESPONDENT CONTENDS THAT HIS INTEREST IN THE PENSION PLAN IS A SECURITY WITHIN THE MEANING OF THE SECURITIES ACTS, THAT ISSUE, IN LIGHT OF THE CIRCUIT COURT'S DENIAL OF THE PETITION FOR REHEARING,NEED NOT BE CONSIDERED.

The Annuity Reserve Fund represents contributions made by Respondent and other retirees during the course of their employment with the Board of Education. Contributions to the plan were compulsory at a fixed minimum level, but most teachers voluntarily contributed more than the minimum requirement as an investment for the future. As a result of alleged violations of the Securities Laws by the Trustees, the corpus of this Annuity Reserve Fund has been depleted by almost $51 million.

Although the City's contribution to the "compensation package" was almost

double that of the majority of present retirees,* it cannot be claimed under the facts here alleged that a $51 million diminution should be overlooked regardless of whether Respondent's investment was based on an expectation of profits.

> " In every case the purchaser gave up some tangible and definable consideration in return for an interest that has substantially the characteristics of a security." [International Brotherhood of Teamsters v. Daniel, 439 U.S. 551 (1979)

As this Court stated in S.E.C. v. Howey, 328, U.S. 293 (1946)

> "The statutory policy of affording broad protection to investors is not to be thwarted by unrealistic and irrelevant formulae".

The distinction between this action and Daniel is obvious. The consideration given by Respondent was not abstract

*Based upon the 1970 fiscal report.

in the sense that this Court treated Daniel's exchange of labor for pension benefits. Respondent's contribution was in part compulsory, in part voluntary and contributory. This constitutes an "investment contract" within the meaning and intent of the Securities Acts.

In reversing the District Court's dismissal of the complaint insofar as the Securities Acts claims are concerned, the Circuit Court held that a trust beneficiary "like the shareholder in a derivative suit, has standing to attack securities frauds perpetrated a threatened by the trustees of his fund".(14A) Clearly this is reflective of and in full accord with Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975)

> "Third are shareholders, creditors and perhaps others related to an issuer who suffered loss in the

> value of their investment due to corporate or insider activities in connection with the purchase or sale of securities which violate Rule 10b-5. It has been held that shareholder members of the second and third of these classes may frequently be able to circumvent the Birnbaum limitation through bringing a derivative action on behalf of the corporate issuer if the latter is itself a purchaser or seller of securities. See, e.g., Schoenbaum v. Firstbrook, 405 F2d 215, 219 (CA2 1968), cert denied sub nom Manley v. Schoenbaum, 395 US 906, 23 L Ed 2d 219, 89 S Ct 1747 (1969)".

Since public retirement systems are excluded under ERISA's, detailed and complex regulations, protection against securities laws violations and breaches of fiduciary obligations by trustees empowered to manage such funds must be sought in the courts. Under Article V, Section 7 of the Constitution of the State of New York, membership in a public pension system is contractual in nature, and the benefits derived there-

from are to be neither diminished nor impaired. The source from which the benefits are derived must likewise be protected.

> " Close examination is therefore required of any radical change in means chosen to maintain the integrity and security of the sources from which the concededly protected benefits are to be paid". (Sgaglione v. Levitt, 37 N.Y. 2d 507, 512)

Here, the source has been diminished and impaired as a result of violations of securities laws by the fund's trustees in securing the right to purchase low grade New York City securities in exchange for a portfolio of high quality securities in not disclosing material facts which would have negated such action. This derivative suit by a beneficiary of the fund who sustained damage as a result of these Securities Laws violation is a proper means of obtaining redress for such wrongs.

2. THE TRUSTEES'CONDUCT IN FRAUD-ULENTLY OBTAINING A FAVORABLE RULING FROM IRS WHICH ENABLED THE FUND TO PURCHASE NEW YORK CITY AND MAC SECURITIES WAS DECEPTIVE AND VIOLATIVE OF THE SECURITIES LAWS.

In November, 1975 an agreement was reached wherein the Trustees agreed to acquire New York City securities over a 30 months period (6A). In December, 1975 the Trustees requested IRS to rule that these purchases were not prohibited transactions, and in seeking IRS approval the Trustees allegedly did not disclose:

> " (1) that the banks had sold City obligations in the previous year; (2) that City serial bonds were to be purchased at par when available at a discount; (3) the purchases would increase fund holdings of City obligations "to 32%"; (4) the Board intended to sell sound corporate bonds to raise cash to make these purchases; (5) the purchases were not for the exclusive benefit of beneficiaries". (7A)

The complaint alleges that the Trustees purchased the City and MAC securities with full knowledge of the

City's serious financial condition. (2) The deliberate nondisclosure by the Purchaser-Trustees to IRS of these facts, known to the seller as well, enabled the Trustee, with the complicity of the seller, to obtain a favorable ruling and made the purchase of the securities a <u>fait accompli</u>.

<u>Santa Fe Industries Inc. v. Green</u>, 430 U.S. 462, (1977) holds that a breach of fiduciary duty without deception, misrepresentation or nondisclosure does not constitute a violations of the securities laws. <u>Santa Fe</u>, however, utilized the language previously employed by this Court in <u>Superintendent of Insurance v. Bankers Life & Cas. Co</u>.404 U.S. 6, 12-13 (1977):

> " '§10(B) must be read flexibly not technically and restrictively' and that the statue provides a cause of action for any plaintiff who 'suffers an injury as a result of

deceptive practices touching its sale (or purchase) of securities...' "(Santa Fe, supra at 475)

The Trustees' conduct as here alleged "touched" the purchase of securities. In O'Brien v. Continental Illinois National Bank and Trust,*593 F2d 54 (7th Cir. 1979) citing Santa Fe, at 477-478, the Court significantly stated,

> "...§10(b)'s fundamental purpose [is] requiring full and fair disclosure to participants in securities transactions of the information that would be useful to them in deciding whether to buy or sell securities". (at 60)

Here, although the investment decision of the Trustees was allegedly made with full knowledge of all material facts,

> "...disclosure to the directors, even the entire board, does not

* The decision of whether or not to terminate the Trust was not within the penumbra of 10(b).

> necessarily foreclose a §10(b) and Rule 10(b)-5 claim in favor of the corporation". Maldonado v. Flynn, 448 F Supp.1032, 1037 (S.D.N.Y. 1978)

See also Schoenbaum v. Firstbrook, 405 F.2d 215 (2d Cir. 1968), cert. denied sub nom. Manley v. Schoenbaum 395 U.S. 906 (1969)

3. A PRIVATE CAUSE OF ACTION IS RECOGNIZED UNDER §17A OF THE SECURITIES ACT OF 1933.

Appellant's reliance upon Touche Ross & Co. v. Redington ______U.S. ______, 99 S.Ct. 2479 (1979) and Cannon v. University of Chicago, ______U.S. ______, 99 S.Ct. 1946 (1979) is misplaced. In Redington this Court determined that a customer of a brokerage firm required to maintain records and file reports by §17(a) of the Securities Exchange Act of 1934, 15 USC §78q(a) did not have an implied cause of action for damages

under this section against accountants who audit such required reports which action was based upon misstatements allegedly contained in the reports. In deciding Redington this Court held:

> " Instead, our task is limited soley to determining whether Congress intended to create the private right of action asserted by SIPC and the Trustee. And as with any case involving the interpetation of a statute, our analysis must begin with the language of the statute itself". 61 L Ed 2d at 91.

The Court found that the statute construed did not create a private cause of action in favor of anyone. No class was identifiable to which private rights could be attributed nor did the statute proscribe any conduct as unlawful.

Respondent's action here attacked is brought under §17(a) of the Securities Act of 1933, (15 USC §77q) a statute

not discussed in Redington. This Court has heretofore elected to express no view as to whether this section provides a private party with an implied cause of action for damages. (Daniel, supra, 58 L. Ed. 2d at 815, note 9)

Respondent's derivative suit must stand as a viable claim under §17(a) of the 1933 Act. The Trustees of the fund are sued on behalf of the fund by a beneficiary to recover that portion of the corpus of the fund dissipated by the wrongful acts of the Trustees who are alleged to have violated applicable securities laws. Who but a beneficiary suing derivatively could seek such redress for these wrongs? See Person v. New York Post Corp., 427 F. Supp.1297 (S.D.N.Y. 1977), affd. without op. 573 F 2d 1294 (2d Cir. 1977).

In S.E.C. v. Texas Gulf Sulphur Co., 401 F. 2d 833, 867 (2d Cir.1968) the Court (Friendly, J.) observed:

> " Once it had been established however, that an aggrieved buyer has a private action under §10(b) of the 1934 Act, there seemed little practical point in denying the existence of such an action under §17__ with the important proviso that fraud, as distinct from mere negligence, must be alleged".

See also Globus v. Law Research Service, Inc., 418 F. 2d 1276, 1283-1284 (2d Cir. 1969).

Based upon Respondent's status as a beneficiary of the subject pension fund, suing the trustees of the fund derivatively under §17(a) of the 1933 Act, the "four factors" described in Cort v. Ash, 422 US 66 (1975) and reiterated in Cannon v. University of Chicago, supra, have been satisfied.

> " We agree with the Seventh Circuit that the language of §17 is broad

> enough to imply a private right of action and that the beneficiaries of the Trust are persons claiming injury for the alleged fraud in purchase and sale of securities". (16A)

CONCLUSION

THE WRIT OF CERTIORARI SHOULD BE DENIED

November 8, 1978

Respectfully submitted,

ALFRED KIRSHNER
Respondent, pro se

FOOTNOTES

(1) Respondent's complaint, as the Circuit Court notes, contains other factual allegations of Securities Laws violations.

(2) Appellants do not raise the "scienter" issue in their Petition. The Circut Court found scienter to be sufficiently alleged in the complaint. (14A-15A)

In the

Supreme Court of the United States

October Term, 1979

No. 79-640

Bernard Goldberg, Reuben Mitchell, Joseph Shannon, Robert Christen, Victor Condello, Harrison J. Goldin, James Regan, individually and as Trustees of the Teachers' Retirement System of the City of New York and Isaiah Robinson, individually as former Trustee of Teachers' Retirement System,

Petitioners,

v.

Alfred Kirshner,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF *AMICUS CURIAE* OF MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED

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Of Counsel:

Brown, Wood, Ivey, Mitchell & Petty

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

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BERNARD GOLDBERG, REUBEN MITCHELL, JOSEPH SHANNON, ROBERT CHRISTEN, VICTOR CONDELLO, HARRISON J. GOLDIN, JAMES REGAN, individually and as Trustees of the Teachers' Retirement System of the City of New York and ISAIAH ROBINSON, individually as former Trustee of Teachers' Retirement System,

Petitioners,

v.

ALFRED KIRSHNER,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MOTION OF MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") hereby respectfully moves pursuant to Rule 42 of this Court for leave to file the annexed brief in support of the Petition for a Writ of Certiorari. The consent of the Corporation Counsel of the City of New York on behalf of the Petitioners has been obtained. Consent of the Respondent has been requested and refused.

Merrill Lynch is the largest broker-dealer in the United States, and is actively involved in the municipal securities market. As such, Merrill Lynch has a substantial interest

in the nature and scope of liability that may be implied under the antifraud provisions of the federal securities laws with respect to transactions in municipal securities. In addition, Merrill Lynch is a defendant in a number of class actions pending in the United States District Court for the Southern District of New York, consolidated under the caption *In Re New York City Municipal Securities Litigation,* MDL Docket No. 314, M-21-22. Those actions, like this action, arise out of the New York City fiscal crisis, and, like this action, present questions as to the propriety of allowing an implied right of action under the antifraud provisions of the federal securities laws with respect to transactions in municipal securities. Merrill Lynch and certain other defendants have moved to dismiss those actions on the grounds that no such private right of action may be implied; Merrill Lynch is therefore acutely interested in having this Court resolve the related questions presented by the Petition.

Merrill Lynch strongly believes that the Second Circuit Court of Appeals erred below in assuming the existence of an implied right of action under Section 17(a) of the Securities Act of 1933 and under Section 10(b) of the Securities Exchange Act of 1934 with respect to transactions in municipal securities. The Second Circuit's ruling seriously conflicts with this Court's subsequent decisions in *Cannon* v. *University of Chicago,* 99 S. Ct. 1946 (May 14, 1979), and *Touche Ross & Co.* v. *Redington,* 99 S. Ct. 2479 (June 18, 1979). The language, structure, purpose and legislative history of both Acts, which are the relevant factors for implication of private remedies under *Cannon* and *Redington,* all plainly demonstrate that Congress intended no private civil actions under either Act to be available with respect to municipal securities. While the Petition addresses generally the question whether there can be an im-

plied right of action under Section 17(a), it does not focus upon the specific issue of the availability of such a private action with respect to transactions in municipal securities. Merrill Lynch believes, however, that this analysis is the most effective in resolving the important questions of liability presented by the Petition in a manner consistent with the intent of Congress in adopting the federal securities laws.

WHEREFORE, Merrill Lynch respectfully moves this Court that leave be granted to file the annexed brief *amicus curiae.*

Dated: November 2, 1979

Respectfully submitted,

/s/ JAMES B. MAY

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MITCHELL & PETTY

TABLE OF AUTHORITIES

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Petitioners,

v.

ALFRED KIRSHNER,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED AS *AMICUS CURIAE* IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

Preliminary Statement

Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") submits this brief as *amicus curiae*, in support of the Petition for a Writ of Certiorari, and urges this Court to review the opinion and judgment of the United States Court of Appeals for the Second Circuit in *Kirshner v. United States,* 603 F.2d 234 (2d Cir. 1978), *rehearing and rehearing en banc denied,* 603 F.2d 234 (2d Cir. 1979).

Question Presented

Merrill Lynch as *amicus curiae* addresses only the third issue presented in the Petition for Certiorari. This question may be restated and narrowed as follows:

May a private right of action for damages be judicially implied under Section 17(a) of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. § 77q(a), with respect to transactions in municipal securities, despite Congress' clearly expressed intention to exempt municipal securities from all civil liability under the federal securities laws?

Interest Of Merrill Lynch As *Amicus Curiae*

Merrill Lynch is the largest broker-dealer in the United States. It is actively involved in the municipal securities market as a marketmaker, as a broker and dealer, and as an underwriter of a significant number and substantial principal amount of new issues of municipal securities each year. Merrill Lynch therefore has an ongoing interest in the nature and scope of liability arising from transactions in municipal securities that may be implied under the amorphous standards of the general antifraud provisions of the federal securities laws.

In addition, Merrill Lynch is a defendant in several class actions pending in the United States District Court for the Southern District of New York, which have been consolidated under the caption *In Re New York City Municipal Securities Litigation*, MDL Docket No. 314, M-21-22. These actions[1] were brought against various defendants, including

[1] *Friedlander* v. *The City of New York*, 75 Civ. 3981; *Spector* v. *The City of New York*, 75 Civ. 5461; *Goldfarb* v. *The City of New York*, 75 Civ. 5581; *Weisberg* v. *The City of New York*, 75

The City of New York, its former Mayor, its Comptroller, and sixteen underwriters of New York City securities. The complaints allege, *inter alia*, violations of the antifraud provisions of the federal securities laws in connection with the issuance and underwriting of New York City bonds and notes in 1974 and 1975. The civil actions were instituted following certain events known as the New York City fiscal crisis. These events included the collapse of the public market for City notes and bonds, legislative imposition of a moratorium on payment of City notes, and a sharp diminution in the trading value of City notes and bonds.[2]

Civ. 5582; *Manchester* v. *The City of New York*, 77 Civ. 990. The *Friedlander* and *Spector* actions have been certified as class actions. *Friedlander* v. *The City of New York*, 71 F.R.D. 546 (S.D. N.Y. 1976); *Spector* v. *The City of New York*, 71 F.R.D. 550 (S.D.N.Y. 1976). The other actions were consolidated with *Friedlander* and *Spector* for pretrial purposes in the United States District Court for the Southern District of New York before the Hon. Richard Owen, D.J., by the Judicial Panel on Multidistrict Litigation. 439 F. Supp. 267 (J.P.M.L. 1977). Several other individual actions, brought in Massachusetts and in California, have also been consolidated in New York with these class actions for pretrial purposes.

[2] As a consequence of the fiscal crisis, the City was unable to borrow in the public credit markets and, in 1975, Congress enacted the New York City Seasonal Financing Act of 1975, 31 U.S.C. § 1501 *et seq.* Pursuant to that Act, the City was able to meet its seasonal financing needs through direct loans from the federal government. In 1978, the New York City Loan Guarantee Act of 1978, 31 U.S.C. § 1521 *et seq.*, was enacted, pursuant to which the federal government agreed to guarantee repayment of notes and bonds to be issued by the City to New York City and New York State employee pension funds.

This legislation embodies a carefully formulated congressional program for the fiscal recovery of New York City. It is indeed ironic that, if the Second Circuit's ill-considered recognition of a private right of action under Section 17(a) of the Securities Act and Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b), in connection with transactions in City securities were permitted to stand, that legislative plan would be threatened, if not destroyed. If Kirshner were to prevail on his Section 17(a) or 10(b) claims, the City pension

On August 1, 1979, Merrill Lynch and certain other defendants filed a motion to dismiss those actions, upon the grounds that the court should not infer either from Section 17(a) of the Securities Act or from Section 10(b) of the Exchange Act a private right of action for damages in connection with the issuance and underwriting of municipal securities.[3] Since any decision by this Court upon the related question presented by the pending Petition could substantially affect the outcome of the motions in the *New York City Municipal Securities Litigation*, Merrill Lynch has a significant interest in the granting of the Petition.

Merrill Lynch believes that the Second Circuit erred in *Kirshner* in finding a private right of action implicit in Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act with respect to transactions in municipal securities. The legislative history of both Acts reveals that Congress never intended any such private remedy to be available, and, as to municipal securities, there is no history of judicial acceptance of such a private action that might outweigh this otherwise dispositive expression of congressional intent. Although Merrill Lynch has a continuing interest in Congress' efforts at regulation of the municipal securities industry and has supported proposed legislation to that end,[4] Merrill Lynch believes that such regulation is

funds might effectively be precluded from purchasing Municipal Assistance Corporation bonds. The funds' commitments to purchase $625 million of such bonds in the 1979-82 period are a key element in the City's current four year financing program.

[3] Argument was heard on this motion and similar motions by other defendants on September 28, 1979. No decision has been rendered by the court to date.

[4] *See, e.g., Municipal Securities Full Disclosure Act: Hearings on S.2969 and S.2574 Before the Subcomm. on Securities of the Comm. on Banking, Housing and Urban Development*, 94th Cong., 2d Sess. 136-38 (1976) (testimony of Wallace O. Sellers, Vice President of Merrill Lynch).

appropriately effected only in accordance with express statutory remedies provided by Congress, rather than through *ad hoc* judicial determinations as exemplified by the decision below.

Merrill Lynch respectfully urges this Court to grant the Petition for Certiorari in order to forestall the substantial and inappropriate expansion of judicially created remedies invited by the Second Circuit's decision. Although the Court of Appeals did not consider the specific issue of the availability of implied remedies with regard to transactions in *municipal* securities, neither the court nor the parties had the benefit of this Court's recent decisions in *Cannon* v. *University of Chicago*, 99 S. Ct. 1946 (May 14, 1979), and *Touche Ross & Co.* v. *Redington*, 99 S. Ct. 2479 (June 18, 1979) (also reported at [Current] Fed. Sec. L. Rep. (CCH) ¶ 96,894). The Court of Appeals' decision cannot be squared with the standards set forth in *Cannon* and *Redington*; this Court should grant review to ensure that the frustration of congressional intent embodied in the decision below is not compounded through reliance by other courts upon that erroneous decision, coming as it does from a Circuit that has often been recognized as an influential voice in this area of the law.

ARGUMENT

Section 17(a) of the Securities Act Does Not Give Rise to An Implied Cause of Action for Damages in Connection With Transactions in Municipal Securities.

Although Merrill Lynch joins with the Petitioners in asserting that this Court should grant review in order to make clear that no civil action for damages may be implied under Section 17(a) of the Securities Act with regard to *any* type of security, Merrill Lynch respectfully urges that, at the very least, the unavailability of such a remedy in connection with transactions in municipal securities is manifest under the standards set forth by this Court in *Cannon* v. *University of Chicago,* 99 S. Ct. 1946 (May 14, 1979), and *Touche Ross & Co.* v. *Redington,* 99 S. Ct. 2479 (June 18, 1979). In *Cannon* and *Redington,* this Court substantially refined and clarified the test for implication of private remedies articulated in *Cort* v. *Ash,* 422 U.S. 66 (1975). Although this Court reaffirmed generally the propriety of the *Cort* test, *see Cannon* at 1953; *Redington* at 2489, the Court made clear that the "central inquiry remains whether Congress intended to create, either expressly or by implication, a private cause of action," *Redington,* 99 S. Ct. at 2489, and that "[t]he question of the existence of a statutory cause of action is, of course, one of statutory construction." *Id.* at 2485.

Merrill Lynch respectfully submits that the following analysis of congressional intent is required by *Cannon* and *Redington*:

1. The "language and focus of the statute, its legislative history, and its purpose" must indicate that Congress intended a cause of action to be created. *Redington, supra* at 2489.

2. As regards the language of the statute, the critical factor is whether the language is "right-creating" or "duty-creating"; if the language falls in the latter category, the implication of a private remedy is inappropriate. *Cannon, supra* at 1954-55 & n.13; *Redington, supra* at 2489.

3. In analyzing the "focus" and "purpose" of the statute, the existence of express but circumscribed remedies militates against the implication of additional or more expansive remedies. *Redington, supra* at 2487-88.

4. The legislative history of the statute must affirmatively evince congressional intention or understanding that the remedies asserted would be inferred by the courts. *Cannon, supra* at 1956; *Redington, supra* at 2486-87.

Application of this analysis to Section 17(a) of the Securities Act compels the conclusion that no private remedy is available under that Section in connection with transactions in municipal securities. Section 17's "language and focus . . ., its legislative history and its purpose", *Redington,* 99 S. Ct. at 2489, reveal that the creation of a private remedy under that Section by the Second Circuit was wholly inappropriate and should be reversed by this Court.

With regard to the language of Section 17(a), that Section is clearly within the category of statutes that this Court characterized in *Cannon* as "duty-creating". *See Cannon,* 99 S. Ct. at 1954 n.13. In that Section, Congress has not "explicitly conferred a right directly on a class of persons". *Id.* The statutory language, like that of Section 10(b) of the Exchange Act, simply describes certain conduct as "unlawful". Under *Cannon,* therefore, it cannot serve as the basis for an implied cause of action.

Neither the focus nor the purpose of the Securities Act provides any support for implication of a private remedy under Section 17(a). The Securities Act regulates generally the issuance and underwriting of securities (as opposed to aftermarket trading) and, in that connection, provides certain specific and carefully circumscribed civil remedies. *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 195 (1976). The express civil remedies of the Securities Act referred to in *Hochfelder* are those contained in Section 11 (liability for misstatements in a registration statement), Section 12(1) (liability for the sale of unregistered securities), Section 12(2) (liability for misstatements in a prospectus or for misleading oral statements) and Section 15 (responsibility of "controlling persons" for others made liable under Sections 11 and 12). These express remedies are carefully circumscribed, both with respect to the persons upon whom liability may be imposed and with respect to the circumstances giving rise to such liability; moreover, Congress imposed substantial procedural limitations upon the assertion of claims under each of these Sections. *See Hochfelder,* 425 U.S. at 208 n.26, 209 n.27.

Not only did the Securities Act specifically provide for carefully drawn express civil liabilities, it equally specifically excluded municipal securities from those provisions. Section 3(a) of the Securities Act, 15 U.S.C. § 77c(a), provides that except "as hereinafter expressly provided, the provisions of [the Securities Act] shall not apply to" the classes of securities specified in subsections (1) through (11). Subsection (2) of Section 3(a) specifically exempts

> any security issued or guaranteed by . . . any State of the United States, or by any political subdivision of a State or territory, or by any public instrumentality of one or more States or territories . . . .

This exemption applies both to the registration provisions of the Securities Act, Sections 5 through 8, and to its liability provisions, Sections 11 and 12.

It is true that the exemption afforded by Section 3(a)(2) does not extend to Section 17, subsection (c) of which states that "the exemptions provided in section 3 shall not apply to the provisions of this section." It would ignore the teaching of *Cannon* and *Redington,* however, to say that the general antifraud proscription of Section 17(a) can serve as the basis for an implied civil remedy with respect to municipal securities. Congress specifically excluded municipal securities from the express liability provisions of the Securities Act; its intent may not be thwarted by imposing that same liability by judicial implication. Congress, having carefully delineated the persons to whom and the circumstances under which the express liability provisions would apply, would be surprised to find that its efforts in this regard had been vitiated by virtue of an implied remedy lurking in Section 17(a). *See Hochfelder, supra* at 210-11.

The legislative history of the Securities Act reveals that the exemption afforded municipal securities was intended by Congress to insulate municipal securities from all federal civil actions for damages.

Congress was acutely aware of the constitutional limitations upon its authority to regulate state (or municipal) activities, including the issuance of securities.[5] For example, the House Report which accompanied H.R. 5480 (the original version of the Securities Act) commented

[5] It is unnecessary to decide whether Congress correctly perceived a constitutional impediment to federal regulation of municipal securities. The relevant inquiry is what Congress *thought* were the limitations upon its power to regulate. *Moor* v. *County of Alameda,* 411 U.S. 693, 709 (1973).

upon the Section 3(a)(2) exemption for municipal securities, as follows:

> The term "political subdivision" carries with it the exemption of such securities as county, town, or municipal obligations, as well as school district, drainage district, and levee district, and other similar bonds. The line drawn by the expression "political subdivision" corresponds generally with the line drawn by the courts as to what obligations of States, their units and instrumentalities created by them, are exempted from Federal taxation. By such a delineation, any *constitutional difficulties* that might arise with reference to the inclusion of State and municipal obligations are avoided.

H.R. Rep. No. 85, 73d Cong., 1st Sess. 14 (1933) (emphasis added). Congress' concern with constitutional limitations influenced the scope of the express civil liabilities it was willing to provide:

> Sections 11 and 12 create and define the civil liabilities imposed by the Act and the machinery for their enforcement which renders them practically valuable .... To impose a lesser responsibility would nullify the purposes of this legislation. To impose a greater responsibility, *apart from constitutional doubts,* would unnecessarily restrain the conscientious administration of honest business with no compensating advantage to the public.

H.R. Rep. No. 85, *supra* at 9-10 (emphasis added).[6]

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[6] Moreover, there was at that time a general belief that municipal securities were safer and, therefore, less in need of any form of regulation.

> Of course, we do not think that any security of the United States Government, for example, needs the surveillance of the Federal Trade Commission [then the proposed regulatory agency], or a security of a state government.

Federal Securities Act: Hearings Before the House Interstate and Foreign Commerce Comm. on H.R. 4314, 73d Cong., 1st Sess. 29 (1933) (testimony of Huston Thompson, an attorney and former member of the Federal Trade Commission, on the exemption provision of H.R. 4314). Even if this assumption has proved to be less than accurate in recent years, the relevant inquiry in analyzing the legislative history of Section 17 is what Congress thought in 1933, not what Congress might or ought to think now. *See Redington,* 99 S. Ct. at 2488 n.16; *cf.* Frankfurter, *Some Reflections on the Reading of Statutes,* 47 Colum. L. Rev. 527, 534 (1947): "An omission at the time of enactment, whether careless or calculated, cannot be judicially supplied however much later wisdom may recommend the inclusion."

There is abundant evidence in the legislative history of the Section 3(a)(2) exemption that Congress recognized it was exempting municipal securities from *all* federal civil liability. Initially, H.R. 5480 did not extend the 3(a)(2) exemption to Section 12 liability. In the original draft of that bill, submitted to the House on May 4, 1933, Section 12(2) included within its scope all securities, "whether or not exempted by Section 3". On May 10, 1933, H.R. 5480 was amended by the Senate to exclude from the scope of Section 12(2) civil liability various categories of securities, including municipal securities. The issue of the applicability of Section 12(2) to exempted securities was settled by the Conference Committee, and the Conference Report, issued on May 20, 1933, stated that securities "covered" by Section 3(a)(2) would be exempted from the provisions of Section 12(2). *See* H.R. Rep. No. 152, 73d Cong., 1st Sess. 27 (1933).[7] This history documents

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[7] Significantly, Congress did not exclude all types of securities generally exempted by Section 3(a) from the operation of Section 12(2). In fact, Section 12(2) liability extends to *all* securities generally exempted by Section 3(a), except those enumerated specifically in Section 3(a) (2). This underscores Congress' particular concern with the imposition of *any* civil liability with respect to the types of securities, such as municipal securities, specified in Section 3(a)(2).

Congress' intent to exclude municipal securities from any civil liabilities under the Securities Act.[8]

There is no intimation whatsoever in the legislative history of Section 17(a) of the Securities Act that Congress intended this provision to extend civil liability to classes of securities that were exempted from the coverage of Sections 11 and 12, or that Congress anticipated that the courts would provide such an extension. Quite to the contrary, it is clear that Section 17(a) was intended to be the basis for injunctive and criminal actions only. S. 875, the initial Senate bill, included a general antifraud provision (Section 13) similar to that ultimately enacted as Section 17(a); according to the report of the Senate Committee on Banking and Currency, this provision was included so that "[t]he Government may stop the further or threatened fraud or misrepresentation by injunction in the district courts" and "[t]hose guilty of the fraud may be prosecuted criminally by the Attorney General." S. Rep. No. 47, 73d Cong., 1st Sess. 6 (1933).[9]

[8] It is also significant that this conscious exclusion of municipal securities from the registration and civil liability provisions of the Securities Act was adopted despite testimony before Congress urging the elimination of the exemption. *See, e.g., Securities Act: Hearings Before the Senate Comm. on Banking and Currency on S.875*, 73d Cong., 1st Sess. 65-66 (testimony of A. H. Carter of the New York Society of Certified Public Accountants); *id.* at 232 (testimony of M. H. Maclean, Vice-President and Director of Harris Trust & Savings Bank).

[9] This view is reflected in a contemporaneous speech by James M. Landis, one of the authors of the Securities Act and, at that time, a member of the Federal Trade Commission:

> The suggestion has been made on occasion that civil liabilities arise also from a violation of Section 17, the first subsection of which makes unlawful the circulation of falsehoods and untruths in connection with the sale of a security in interstate commerce or through the mails. But a reading of this section in the light of the entire Act leaves no doubt but that violation of its provisions gives rise only to a liability to be restrained by injunctive action or, if wilfully done, to a liability to be punished criminally.

Landis, *Liability Sections of Securities Act Authoritatively Discussed*, 18 Am. Acct. 330, 331 (1933). *See also SEC* v. *Texas Gulf Sulphur Corp.*, 401 F.2d 833, 867 (2d Cir. 1968) (en banc) (Friendly, J., concurring), *cert. denied*, 394 U.S. 976 (1969).

The conclusion that Congress intended to exempt municipal securities from all private civil actions under the Securities Act is supported by the abundant evidence of Congress' similar intent in formulating and adopting the Exchange Act only a year later. Although the Petition for Certiorari does not raise the question of the propriety of inferring a private remedy from Section 10(b) of the Exchange Act, it is nevertheless appropriate to consider the structure and legislative history of the Exchange Act because the two Acts and their legislative histories should be read *in pari materia. See Ernst & Ernst* v. *Hochfelder*, *supra*, 425 U.S. at 206:

> The 1933 and 1934 Acts constitute interrelated components of the federal regulatory scheme governing transactions in securities. . . . As the Court indicated in *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 466 (1969), "the interdependence of the various sections of the securities laws is certainly a relevant factor in any interpretation of the language Congress has chosen . . . ."

The structure of the Exchange Act, like that of the Securities Act, evidences Congress' conscious decision to exempt municipal securities from civil liabilities under the federal securities laws. The express remedies of the Exchange Act do not apply to securities exempted by Section 3(a)(12), which includes municipal securities. Section 9 of the Exchange Act, which provides an express remedy for purchasers and sellers victimized by price manipulations,

does not apply to securities exempted by Section 3(a)(12). 15 U.S.C. § 78i(f). Section 16 applies only to "equity" securities. 15 U.S.C. § 78p. Section 18 applies only to securities "registered" under the Act (which, at the time of its enactment, meant only securities listed on a national securities exchange). 15 U.S.C. § 78r. Furthermore, each express remedy in the Exchange Act is subject to "carefully drawn procedural restrictions . . . ." *Hochfelder*, 425 U.S. at 210.

The legislative history of the Exchange Act reveals that the Congress that had one year earlier declined to create any private actions with respect to municipal securities chose consciously to adhere to that determination in formulating the Exchange Act. Both the House and the Senate considered several bills that failed to exempt municipal securities from the civil remedy provisions, but this provoked much testimony as to the importance of preserving such an exemption. *See, e.g., Stock Exchange Practices: Hearings Before the Senate Banking and Currency Comm. on S. Res. 84, S. Res. 56 and S. Res. 97*, 73d Cong., 1st Sess. 6839-40, 7069, 7276, 7413-14 (1934); *Stock Exchange Regulation: Hearings Before the Comm. on Interstate and Foreign Commerce of the House of Representatives on H.R. 7852 and H.R. 8720*, 73d Cong., 1st Sess. 298-300 (1934). In addition, Congress was asked to consider legislation that would have invested the Securities and Exchange Commission with discretionary authority to exempt municipal securities from the operation of the Act. *See Senate Hearings, supra* at 7476-78. Congress chose, however, to reject the various proposed bills that failed to provide an exemption from private actions for municipal securities; in so doing, Congress unambiguously evidenced its intention to insulate municipal securities from all private civil actions under the federal securities laws.

The foregoing discussion demonstrates that Congress unequivocally intended to exempt municipal securities from the civil remedy provisions of the federal securities laws. To hold, nonetheless, that Section 17(a) can provide a basis for a private right of action through judicial implication would ignore Congress' concern for the dictates of federalism and would violate the standards set forth by this Court in *Cannon* v. *University of Chicago* and *Touche Ross & Co.* v. *Redington*. Merrill Lynch respectfully urges this Court to grant the Petition and thereby avail itself of this opportunity to instruct the lower courts as to the unavailability of a private action under Section 17(a), before the unquestioning acceptance of that remedy by those courts becomes too well established to permit of reexamination.

Conclusion

For the foregoing reasons, a Writ of Certiorari should be issued to review the decision of the United States Court of Appeals for the Second Circuit.

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